

ADOBE SYSTEMS INC  
Form 10-Q  
April 08, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended March 4, 2011

or  
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-15175

ADOBE SYSTEMS INCORPORATED  
(Exact name of registrant as specified in its charter)

\_\_\_\_\_  
Delaware  
(State or other jurisdiction of  
incorporation or organization)

77-0019522  
(I.R.S. Employer  
Identification No.)

345 Park Avenue, San Jose, California 95110-2704  
(Address of principal executive offices and zip code)

(408) 536-6000  
(Registrant's telephone number, including area code)

\_\_\_\_\_  
Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No   
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer   
(Do not check if a smaller reporting company)

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No   
The number of shares outstanding of the registrant's common stock as of April 1, 2011 was 504,458,624.

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ADOBE SYSTEMS INCORPORATED  
FORM 10-Q

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## PART I—FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ADOBE SYSTEMS INCORPORATED  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

|   | March 4,<br>2011<br>(Unaudited) | December 3,<br>2010<br>(*) |
|---|---------------------------------|----------------------------|
| <b>ASSETS</b>   |                                 |                            |
| Current assets:   |                                 |                            |
| Cash and cash equivalents   | \$900,156                       | \$749,891                  |
| Short-term investments  | 1,736,679                       | 1,718,124                  |
| Trade receivables, net of allowances for doubtful accounts of \$15,575 and \$15,233, respectively | 533,353                         | 554,328                    |
| Deferred income taxes   | 66,928                          | 83,247                     |
| Prepaid expenses and other current assets   | 113,682                         | 110,460                    |
| Total current assets  | 3,350,798                       | 3,216,050                  |
| Property and equipment, net   | 453,497                         | 448,881                    |
| Goodwill  | 3,686,073                       | 3,641,844                  |
| Purchased and other intangibles, net  | 447,616                         | 457,263                    |
| Investment in lease receivable  | 207,239                         | 207,239                    |
| Other assets  | 164,801                         | 169,871                    |
| Total assets  | \$8,310,024                     | \$8,141,148                |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                 |                            |
| Current liabilities:  |                                 |                            |
| Trade payables  | \$54,742                        | \$52,432                   |
| Accrued expenses  | 458,463                         | 564,275                    |
| Capital lease obligations   | 8,900                           | 8,799                      |
| Accrued restructuring   | 6,759                           | 8,119                      |
| Income taxes payable  | 57,096                          | 53,715                     |
| Deferred revenue  | 399,572                         | 380,748                    |
| Total current liabilities   | 985,532                         | 1,068,088                  |
| Long-term liabilities:  |                                 |                            |
| Debt and capital lease obligations  | 1,511,553                       | 1,513,662                  |
| Deferred revenue  | 43,826                          | 48,929                     |
| Accrued restructuring   | 7,307                           | 8,254                      |
| Income taxes payable  | 170,721                         | 164,713                    |
| Deferred income taxes   | 120,756                         | 103,098                    |
| Other liabilities   | 44,922                          | 42,017                     |
| Total liabilities   | 2,884,617                       | 2,948,761                  |
| Stockholders' equity:   |                                 |                            |
| Preferred stock, \$0.0001 par value; 2,000 shares authorized, none issued                         | —                               | —                          |
| Common stock, \$0.0001 par value; 900,000 shares authorized; 600,834 shares issued;               | 61                              | 61                         |
| 504,987 and 501,897 shares outstanding, respectively  |                                 |                            |
| Additional paid-in-capital  | 2,529,789                       | 2,458,278                  |

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|  |             |              |
|--|-------------|--------------|
| Retained earnings  | 6,045,631   | 5,980,914    |
| Accumulated other comprehensive income   | 28,695      | 17,428       |
| Treasury stock, at cost (95,847 and 98,937 shares, respectively), net of reissuances | (3,178,769  | ) (3,264,294 |
| Total stockholders' equity   | 5,425,407   | 5,192,387    |
| Total liabilities and stockholders' equity   | \$8,310,024 | \$8,141,148  |

(\*) The Condensed Consolidated Balance Sheet at December 3, 2010 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.  
See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

(Unaudited)

|   | Three Months Ended |                  |   |
|---|--------------------|------------------|---|
|   | March 4,<br>2011   | March 5,<br>2010 |   |
| Revenue:  |                    |                  |   |
| Products  | \$842,689          | \$703,938        |   |
| Subscription  | 106,171            | 95,507           |   |
| Services and support                                | 78,846             | 59,255           |   |
| Total revenue                                       | 1,027,706          | 858,700          |   |
| Cost of revenue:                                    |                    |                  |   |
| Products  | 30,717             | 23,510           |   |
| Subscription  | 47,878             | 45,735           |   |
| Services and support                                | 29,044             | 20,123           |   |
| Total cost of revenue                               | 107,639            | 89,368           |   |
| Gross profit  | 920,067            | 769,332          |   |
| Operating expenses:                                 |                    |                  |   |
| Research and development                            | 178,400            | 174,340          |   |
| Sales and marketing                                 | 328,078            | 297,294          |   |
| General and administrative                          | 100,979            | 91,046           |   |
| Restructuring charges                               | 41                 | 11,622           |   |
| Amortization of purchased intangibles               | 10,235             | 18,197           |   |
| Total operating expenses                            | 617,733            | 592,499          |   |
| Operating income                                    | 302,334            | 176,833          |   |
| Non-operating income (expense):                     |                    |                  |   |
| Interest and other income (expense), net            | (817               | ) 611            |   |
| Interest expense                                    | (17,020            | ) (7,695         | ) |
| Investment gains (losses), net                      | 1,590              | (3,534           | ) |
| Total non-operating income (expense), net           | (16,247            | ) (10,618        | ) |
| Income before income taxes                          | 286,087            | 166,215          |   |
| Provision for income taxes                          | 51,496             | 39,061           |   |
| Net income  | \$234,591          | \$127,154        |   |
| Basic net income per share                          | \$0.47             | \$0.24           |   |
| Shares used to compute basic net income per share   | 504,134            | 524,173          |   |
| Diluted net income per share                        | \$0.46             | \$0.24           |   |
| Shares used to compute diluted net income per share | 511,345            | 532,645          |   |

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|  | Three Months Ended |                  |
|--|--------------------|------------------|
|  | March 4,<br>2011   | March 5,<br>2010 |
| Cash flows from operating activities:  |                    |                  |
| Net income   | \$234,591          | \$127,154        |
| Adjustments to reconcile net income to net cash provided by operating activities:            |                    |                  |
| Depreciation, amortization and accretion   | 66,286             | 68,581           |
| Stock-based compensation   | 70,992             | 64,480           |
| Deferred income taxes  | 28,645             | (157,932)        |
| Unrealized (gains) losses on investments   | (1,330)            | ) 2,331          |
| Tax benefit from employee stock option plans   | —                  | 35,609           |
| Other non-cash items   | 2,703              | 1,313            |
| Excess tax benefits from stock-based compensation  | —                  | (7,058)          |
| Changes in operating assets and liabilities, net of acquired assets and assumed liabilities: |                    |                  |
| Trade receivables, net   | 20,605             | 59,601           |
| Prepaid expenses and other current assets  | (2,716)            | ) 4,180          |
| Trade payables   | 2,310              | (14,716)         |
| Accrued expenses   | (110,084)          | ) (54,292)       |
| Accrued restructuring  | (2,526)            | ) (18,716)       |
| Income taxes payable   | 8,905              | 106,740          |
| Deferred revenue   | 13,721             | 42,586           |
| Net cash provided by operating activities  | 332,102            | 259,861          |
| Cash flows from investing activities:  |                    |                  |
| Purchases of short-term investments  | (375,077)          | ) (400,054)      |
| Maturities of short-term investments   | 134,296            | 78,958           |
| Proceeds from sales of short-term investments  | 217,407            | 140,611          |
| Purchases of property and equipment  | (32,421)           | ) (25,547)       |
| Acquisitions, net of cash acquired   | (36,572)           | ) —              |
| Purchases of long-term investments and other assets  | (5,389)            | ) (5,747)        |
| Proceeds from sale of long-term investments  | 2,755              | 719              |
| Other  | (124)              | ) 2,341          |
| Net cash used for investing activities   | (95,125)           | ) (208,719)      |
| Cash flows from financing activities:  |                    |                  |
| Purchases of treasury stock  | (125,000)          | ) (20)           |
| Proceeds from issuance of treasury stock   | 40,651             | 49,824           |
| Excess tax benefits from stock-based compensation  | —                  | 7,058            |
| Proceeds from debt   | —                  | 1,493,439        |
| Repayment of debt and capital lease obligations  | (2,169)            | ) (1,000,058)    |
| Debt issuance costs  | —                  | (10,142)         |
| Net cash (used for) provided by financing activities   | (86,518)           | ) 540,101        |
| Effect of foreign currency exchange rates on cash and cash equivalents                       | (194)              | ) (1,288)        |
| Net increase in cash and cash equivalents  | 150,265            | 589,955          |
| Cash and cash equivalents at beginning of period   | 749,891            | 999,487          |
| Cash and cash equivalents at end of period   | \$900,156          | \$1,589,442      |

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Supplemental disclosures:

|  |           |          |
|--|-----------|----------|
| Cash paid for income taxes, net of refunds                                 | \$ 16,413 | \$54,664 |
| Cash paid for interest   | \$31,623  | \$2,617  |
| Non-cash investing activities:   |           |          |
| Issuance of common stock and stock awards assumed in business acquisitions | \$549     | \$—      |

See accompanying Notes to Condensed Consolidated Financial Statements.



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ADOBE SYSTEMS INCORPORATED  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

NOTE 1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

We have prepared the accompanying unaudited Condensed Consolidated Financial Statements pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Pursuant to these rules and regulations, we have condensed or omitted certain information and footnote disclosures we normally include in our annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). In management's opinion, we have made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present our financial position, results of operations and cash flows. Our interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. Certain immaterial prior year amounts have been reclassified to conform to current year presentation in the Condensed Consolidated Statements of Cash Flows. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in our Annual Report on Form 10-K for the fiscal year ended December 3, 2010 on file with the SEC. The three months ended March 5, 2010 financial results benefited from an extra week in the first quarter of fiscal 2010 due to our 52/53 week financial calendar whereby fiscal 2010 was a 53-week year compared with fiscal 2011 which is a 52-week year.

There have been no material changes to our significant accounting policies as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 3, 2010.

Recent Accounting Pronouncements

There have been no new accounting pronouncements during the three months ended March 4, 2011, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the fiscal year ended December 3, 2010, that are of significance, or potential significance, to us.

NOTE 2. ACQUISITIONS

Demdex

On January 18, 2011, we completed our acquisition of privately held Demdex, a data management platform company. The impact of this acquisition was not material to our consolidated balance sheets and results of operations.

Day Software Holding AG

On October 28, 2010, we completed our acquisition of Day Software Holding AG ("Day"), a provider of Web content management solutions that many leading global enterprises rely on for Web 2.0 content application and content infrastructure. Day is based in Basel, Switzerland and Boston, Massachusetts. We believe that our acquisition of Day has enabled us to provide comprehensive solutions to create, manage, deliver and optimize Web content. Following the closing, we integrated Day as a product line within our Enterprise segment for financial reporting purposes. We have included the financial results of Day in our Condensed Consolidated Financial Statements beginning on the acquisition date.

Under the acquisition method of accounting, the total preliminary purchase price was allocated to Day's net tangible and intangible assets based upon their estimated fair values as of October 28, 2010. The total preliminary purchase price for Day was approximately \$248.3 million of which approximately \$157.0 million was allocated to goodwill, \$79.2 million to substantially all of the identifiable intangible assets and \$9.0 million to net tangible assets. The impact of this acquisition was not material to our consolidated balance sheets and results of operations.

NOTE 3. CASH, CASH EQUIVALENTS AND SHORT-TERM INVESTMENTS

Cash equivalents consist of instruments with remaining maturities of three months or less at the date of purchase. We classify all of our cash equivalents and short-term investments as "available-for-sale." In general, these investments are free of trading restrictions. We carry these investments at fair value, based on quoted market prices or other readily

available market information. Unrealized gains and losses, net of taxes, are included in accumulated other comprehensive income, which is reflected as a separate component of stockholders' equity in our Condensed Consolidated Balance Sheets. Gains and losses are recognized when realized in our Condensed Consolidated Statements of Income. When we have determined that an other-than-temporary decline in fair value has occurred, the amount of the decline that is related to a credit loss is recognized in income. Gains and losses are determined using the specific identification method.

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Cash, cash equivalents and short-term investments consisted of the following as of March 4, 2011 (in thousands):

|   | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|---|-------------------|---------------------|----------------------|-------------------------|
| Current assets:   |                   |                     |                      |                         |
| Cash  | \$87,027          | \$—                 | \$—                  | \$87,027                |
| Cash equivalents:                                       |                   |                     |                      |                         |
| Commerical paper  | 60,240            | —                   | —                    | 60,240                  |
| Foreign government securities                           | 4,299             | —                   | —                    | 4,299                   |
| Money market mutual funds and repurchase agreements     | 671,614           | —                   | —                    | 671,614                 |
| Municipal securities                                    | 970               | —                   | —                    | 970                     |
| Time deposits   | 60,502            | —                   | —                    | 60,502                  |
| U.S. agency securities                                  | 3,999             | —                   | —                    | 3,999                   |
| U.S. Treasury securities                                | 11,506            | —                   | (1                   | ) 11,505                |
| Total cash equivalents                                  | 813,130           | —                   | (1                   | ) 813,129               |
| Total cash and cash equivalents                         | 900,157           | —                   | (1                   | ) 900,156               |
| Short-term fixed income securities:                     |                   |                     |                      |                         |
| Corporate bonds and commercial paper                    | 967,463           | 6,988               | (1,719               | ) 972,732               |
| Foreign government securities                           | 16,500            | 159                 | —                    | 16,659                  |
| Municipal securities                                    | 119,085           | 76                  | (35                  | ) 119,126               |
| U.S. agency securities                                  | 215,385           | 678                 | (254                 | ) 215,809               |
| U.S. Treasury securities                                | 396,815           | 2,155               | (461                 | ) 398,509               |
| Subtotal  | 1,715,248         | 10,056              | (2,469               | ) 1,722,835             |
| Marketable equity securities                            | 11,034            | 2,810               | —                    | 13,844                  |
| Total short-term investments                            | 1,726,282         | 12,866              | (2,469               | ) 1,736,679             |
| Total cash, cash equivalents and short-term investments | \$2,626,439       | \$12,866            | \$(2,470             | ) \$2,636,835           |

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Cash, cash equivalents and short-term investments consisted of the following as of December 3, 2010 (in thousands):

|   | Amortized<br>Cost | Unrealized<br>Gains | Unrealized<br>Losses | Estimated<br>Fair Value |
|---|-------------------|---------------------|----------------------|-------------------------|
| Current assets:   |                   |                     |                      |                         |
| Cash  | \$98,691          | \$—                 | \$—                  | \$98,691                |
| Cash equivalents:                                       |                   |                     |                      |                         |
| Commercial paper  | 41,389            | —                   | —                    | 41,389                  |
| Money market mutual funds and repurchase agreements     | 477,259           | —                   | —                    | 477,259                 |
| Municipal securities                                    | 350               | —                   | —                    | 350                     |
| Time deposits   | 64,006            | —                   | —                    | 64,006                  |
| U.S. Treasury securities                                | 68,195            | 1                   | —                    | 68,196                  |
| Total cash equivalents                                  | 651,199           | 1                   | —                    | 651,200                 |
| Total cash and cash equivalents                         | 749,890           | 1                   | —                    | 749,891                 |
| Short-term fixed income securities:                     |                   |                     |                      |                         |
| Corporate bonds and commercial paper                    | 977,889           | 8,079               | (1,450)              | ) 984,518               |
| Foreign government securities                           | 33,079            | 309                 | (2)                  | ) 33,386                |
| Municipal securities                                    | 119,608           | 29                  | (32)                 | ) 119,605               |
| U.S. agency securities                                  | 229,772           | 778                 | (179)                | ) 230,371               |
| U.S. Treasury securities                                | 336,441           | 2,828               | (209)                | ) 339,060               |
| Subtotal  | 1,696,789         | 12,023              | (1,872)              | ) 1,706,940             |
| Marketable equity securities                            | 11,196            | 1,122               | (1,134)              | ) 11,184                |
| Total short-term investments                            | 1,707,985         | 13,145              | (3,006)              | ) 1,718,124             |
| Total cash, cash equivalents and short-term investments | \$2,457,875       | \$13,146            | \$(3,006)            | ) \$2,468,015           |

See Note 4 for further information regarding the fair value of our financial instruments.

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category, that have been in a continuous unrealized loss position for less than twelve months, as of March 4, 2011 and December 3, 2010 (in thousands):

|                                      | 2011          |                               | 2010          |                               |
|--------------------------------------|---------------|-------------------------------|---------------|-------------------------------|
|                                      | Fair<br>Value | Gross<br>Unrealized<br>Losses | Fair<br>Value | Gross<br>Unrealized<br>Losses |
| Corporate bonds and commercial paper | \$258,438     | \$(1,719)                     | ) \$257,615   | \$(1,450)                     |
| Foreign government securities        | —             | —                             | 4,531         | (2)                           |
| Marketable equity securities         | —             | —                             | 9,380         | (1,134)                       |
| Municipal securities                 | 41,465        | (35)                          | ) 43,028      | (32)                          |
| U.S. Treasury and agency securities  | 204,967       | (716)                         | ) 192,702     | (388)                         |
| Total                                | \$504,870     | \$(2,470)                     | ) \$507,256   | \$(3,006)                     |

As of March 4, 2011 and December 3, 2010, there were no securities in a continuous unrealized loss position for more than twelve months. There were 177 securities and 168 securities that were in an unrealized loss position at March 4, 2011 and at December 3, 2010, respectively.



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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the cost and estimated fair value of short-term fixed income securities classified as short-term investments based on stated maturities as of March 4, 2011 (in thousands):

|                        | Amortized<br>Cost | Estimated<br>Fair Value |
|------------------------|-------------------|-------------------------|
| Due within one year    | \$689,449         | \$691,668               |
| Due within two years   | 521,950           | 525,443                 |
| Due within three years | 425,782           | 426,909                 |
| Due after three years  | 78,067            | 78,815                  |
| Total                  | \$1,715,248       | \$1,722,835             |

We review our debt and marketable equity securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. We consider factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and our intent to sell, or whether it is more likely than not we will be required to sell, the investment before recovery of the investment's amortized cost basis. If we believe that an other-than-temporary decline exists in one of these securities, we write down these investments to fair value. For debt securities, the portion of the write-down related to credit loss would be recorded to interest and other income, net in our Condensed Consolidated Statements of Income. Any portion not related to credit loss would be recorded to accumulated other comprehensive income, which is reflected as a separate component of stockholders' equity in our Condensed Consolidated Balance Sheets. For equity securities, the write-down would be recorded to investment gains (losses), net in our Condensed Consolidated Statements of Income. As of March 4, 2011, we did not consider any of our investments to be other-than-temporarily impaired.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## NOTE 4. FAIR VALUE MEASUREMENTS

We measure certain financial assets and liabilities at fair value on a recurring basis. There have been no transfers between fair value measurement levels during the three months ended March 4, 2011.

The fair value of our financial assets and liabilities at March 4, 2011 was determined using the following inputs (in thousands):

|   | Fair Value Measurements at Reporting Date Using |  |   |  |
|---|---|--|---|--|
|   | Total   | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Assets:   |   |  |   |  |
| Cash equivalents:                                   |   |  |   |  |
| Commercial paper                                    | \$60,240  | \$—  | \$60,240  | \$—  |
| Foreign Government Securities                       | 4,299   | —  | 4,299   | —  |
| Money market mutual funds and repurchase agreements | 671,614   | 671,614  | —   | —  |
| Municipal securities                                | 970   | —  | 970   | —  |
| Time deposits                                       | 60,502  | 60,502   | —   | —  |
| U.S. agency securities                              | 3,999   | —  | 3,999   | —  |
| U.S. Treasury securities                            | 11,505  | —  | 11,505  | —  |
| Short-term investments:                             |   |  |   |  |
| Corporate bonds and commercial paper                | 972,732   | —  | 972,732   | —  |
| Foreign government securities                       | 16,659  | —  | 16,659  | —  |
| Marketable equity securities                        | 13,844  | 13,844   | —   | —  |
| Municipal securities                                | 119,126   | —  | 119,126   | —  |
| U.S. agency securities                              | 215,809   | —  | 215,809   | —  |
| U.S. Treasury securities                            | 398,509   | —  | 398,509   | —  |
| Prepaid expenses and other current assets:          |   |  |   |  |
| Foreign currency derivatives                        | 7,649   | —  | 7,649   | —  |
| Other assets:                                       |   |  |   |  |
| Deferred compensation plan assets                   | 13,148  | 635  | 12,513  | —  |
| Total assets  | \$2,570,605                                     | \$746,595  | \$1,824,010   | \$—  |
| Liabilities:  |   |  |   |  |
| Accrued expenses:                                   |   |  |   |  |
| Foreign currency derivatives                        | \$7,192   | \$—  | \$7,192   | \$—  |
| Total liabilities                                   | \$7,192   | \$—  | \$7,192   | \$—  |

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The fair value of our financial assets and liabilities at December 3, 2010 was determined using the following inputs (in thousands):

|   | Fair Value Measurements at Reporting Date Using |  |   |  |
|---|---|--|---|--|
|   | Total   | Quoted Prices<br>in Active<br>Markets for<br>Identical Assets<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| Assets:   |   |  |   |  |
| Cash equivalents:                                   |   |  |   |  |
| Commercial paper                                    | \$41,389  | \$—  | \$41,389  | \$—  |
| Money market mutual funds and repurchase agreements | 477,259   | 477,259  | —   | —  |
| Municipal securities                                | 350   | —  | 350   | —  |
| Time deposits                                       | 64,006  | 64,006   | —   | —  |
| U.S. Treasury securities                            | 68,196  | —  | 68,196  | —  |
| Short-term investments:                             |   |  |   |  |
| Corporate bonds and commercial paper                | 984,518   | —  | 984,518   | —  |
| Foreign government securities                       | 33,386  | —  | 33,386  | —  |
| Marketable equity securities                        | 11,184  | 11,184   | —   | —  |
| Municipal securities                                | 119,605   | —  | 119,605   | —  |
| U.S. agency securities                              | 230,371   | —  | 230,371   | —  |
| U.S. Treasury securities                            | 339,060   | —  | 339,060   | —  |
| Prepaid expenses and other current assets:          |   |  |   |  |
| Foreign currency derivatives                        | 18,821  | —  | 18,821  | —  |
| Other assets:                                       |   |  |   |  |
| Deferred compensation plan assets                   | 11,071  | 617  | 10,454  | —  |
| Total assets  | \$2,399,216                                     | \$553,066  | \$1,846,150   | \$—  |
| Liabilities:  |   |  |   |  |
| Accrued expenses:                                   |   |  |   |  |
| Foreign currency derivatives                        | \$1,945   | \$—  | \$1,945   | \$—  |
| Total liabilities                                   | \$1,945   | \$—  | \$1,945   | \$—  |

See Note 3 for further information regarding the fair value of our financial instruments.

Our fixed income available-for-sale securities consist of high quality, investment grade securities from diverse issuers with a minimum credit rating of A- and a weighted average credit rating of AA. We value these securities based on pricing from pricing vendors, who may use quoted prices in active markets for identical assets (Level 1 inputs) or inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs) in determining fair value. However, we classify all of our fixed income available-for-sale securities as having Level 2 inputs. The valuation techniques used to measure the fair value of our financial instruments having Level 2 inputs were derived from non-binding market consensus prices that are corroborated by observable market data, quoted market prices for similar instruments, or pricing models, such as discounted cash flow techniques. Our procedures include controls to ensure that appropriate fair values are recorded such as comparing prices obtained from multiple independent sources.



We also have direct investments in privately held companies accounted for under the cost method, which are periodically assessed for other-than-temporary impairment. If we determine that an other-than-temporary impairment has occurred, we write-down the investment to its fair value. We estimate fair value of our cost method investments considering available information such as pricing in recent rounds of financing, current cash positions, earnings and cash flow forecasts, recent operational

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

performance and any other readily available market data. For the three months ended March 4, 2011, we determined there were no other-than-temporary impairments on our cost method investments. See Note 7 for further information regarding our cost method investments.

NOTE 5. DERIVATIVES AND HEDGING ACTIVITIES

In countries outside the U.S., we transact business in U.S. Dollars and in various other currencies. Therefore, we are subject to exposure from movements in foreign currency rates. We may use foreign exchange option contracts or forward contracts to hedge certain operational (“cash flow”) exposures resulting from changes in foreign currency exchange rates. These foreign exchange contracts, carried at fair value, may have maturities between one and twelve months. The maximum original duration of any contract is twelve months. We enter into these foreign exchange contracts to hedge a portion of our forecasted foreign currency denominated revenue in the normal course of business and accordingly, they are not speculative in nature.

We recognize derivative instruments from hedging activities as either assets or liabilities on the balance sheet and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on hedged transactions. We record changes in the intrinsic value of these cash flow hedges in accumulated other comprehensive income in our Condensed Consolidated Balance Sheets, until the forecasted transaction occurs. When the forecasted transaction occurs, we reclassify the related gain or loss on the cash flow hedge to revenue. In the event the underlying forecasted transaction does not occur, or it becomes probable that it will not occur, we reclassify the gain or loss on the related cash flow hedge from accumulated other comprehensive income to interest and other income, net in our Condensed Consolidated Statements of Income at that time.

We also hedge our net recognized foreign currency assets and liabilities with foreign exchange forward contracts to reduce the risk that our earnings and cash flows will be adversely affected by changes in exchange rates. These derivative instruments hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value with changes in the fair value recorded to interest and other income (expense), net in our Condensed Consolidated Statements of Income. These derivative instruments do not subject us to material balance sheet risk due to exchange rate movements because gains and losses on these derivatives are intended to offset gains and losses on the assets and liabilities being hedged.

We mitigate concentration of risk related to foreign currency hedges as well as interest rate hedges through a policy that establishes counterparty limits. The bank counterparties to these contracts expose us to credit-related losses in the event of their nonperformance. However, to mitigate that risk, we only contract with counterparties who meet our minimum requirements under our counterparty risk assessment process. In addition, our hedging policy establishes maximum limits for each counterparty. We monitor ratings, credit spreads and potential downgrades on at least a quarterly basis. Based on our on-going assessment of counterparty risk, we will adjust our exposure to various counterparties.

The aggregate fair value of derivative instruments in net asset positions as of March 4, 2011 and December 3, 2010 was \$7.6 million and \$18.8 million, respectively. These amounts represent the maximum exposure to loss at the reporting date as a result of all of the counterparties failing to perform as contracted. This exposure could be reduced by up to \$7.2 million and \$1.9 million, respectively, of liabilities included in master netting arrangements with those same counterparties.



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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The fair value of derivative instruments on our Condensed Consolidated Balance Sheets as of March 4, 2011 and December 3, 2010 were as follows (in thousands):

|  | 2011<br>Fair Value<br>Asset<br>Derivatives <sup>(1)</sup> | Fair Value<br>Liability<br>Derivatives <sup>(2)</sup> | 2010<br>Fair Value<br>Asset<br>Derivatives <sup>(1)</sup> | Fair Value<br>Liability<br>Derivatives <sup>(2)</sup> |
|--|---|---|---|---|
| Derivatives designated as hedging instruments:     |   |   |   |   |
| Foreign exchange option contracts <sup>(3)</sup>   | \$5,175   | \$—   | \$6,092   | \$—   |
| Derivatives not designated as hedging instruments: |   |   |   |   |
| Foreign exchange forward contracts                 | 2,474   | 7,192   | 12,729  | 1,945   |
| Total derivatives                                  | \$7,649   | \$7,192   | \$18,821  | \$1,945   |

(1) Included in prepaid expenses and other current assets on our Condensed Consolidated Balance Sheets.

(2) Included in accrued expenses on our Condensed Consolidated Balance Sheets.

(3) Hedging effectiveness expected to be recognized to income within the next twelve months.

The effect of derivative instruments designated as cash flow hedges and of derivative instruments not designated as hedges in our Condensed Consolidated Statements of Income for three months ended March 4, 2011 and March 5, 2010 was as follows (in thousands):

|  | 2011<br>Foreign<br>Exchange<br>Option<br>Contracts | Foreign<br>Exchange<br>Forward<br>Contracts | 2010<br>Foreign<br>Exchange<br>Option<br>Contracts | Foreign<br>Exchange<br>Forward<br>Contracts |
|--|--|---|--|---|
| Derivatives in cash flow hedging relationships:  |  |   |  |   |
| Net gain (loss) recognized in OCI, net of tax <sup>(1)</sup>                             | \$67   | \$—   | \$10,364   | \$—   |
| Net gain (loss) reclassified from accumulated OCI into income, net of tax <sup>(2)</sup> | \$—  | \$—   | \$—  | \$—   |
| Net gain (loss) recognized in income <sup>(3)</sup>                                      | \$(8,306   | ) \$—                                       | \$(3,921   | ) \$—                                       |
| Derivatives not designated as hedging relationships:                                     |  |   |  |   |
| Net gain (loss) recognized in income <sup>(4)</sup>                                      | \$—  | \$(10,150                                   | ) \$—  | \$11,040                                    |

(1) Net change in the fair value of the effective portion classified in other comprehensive income ("OCI").

(2) Effective portion classified as revenue.

(3) Ineffective portion and amount excluded from effectiveness testing classified in interest and other income (expense), net.

(4) Classified in interest and other income (expense), net.

## NOTE 6. GOODWILL AND PURCHASED AND OTHER INTANGIBLES

Goodwill as of March 4, 2011 and December 3, 2010 was \$3.686 billion and \$3.642 billion, respectively. The increase is due to our acquisition of Demdex and foreign currency translation adjustments offset in part by insignificant

adjustments to our Day preliminary purchase price allocation.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Purchased and other intangible assets subject to amortization as of March 4, 2011 and December 3, 2010 was as follows (in thousands):

|  | 2011      |                          |           | 2010      |                          |           |
|--|-----------|--------------------------|-----------|-----------|--------------------------|-----------|
|  | Cost      | Accumulated Amortization | Net       | Cost      | Accumulated Amortization | Net       |
| Purchased technology                       | \$274,258 | \$ (73,750 )             | \$200,508 | \$260,198 | \$ (61,987 )             | \$198,211 |
| Localization                               | \$15,489  | \$ (10,422 )             | \$5,067   | \$14,768  | \$ (9,355 )              | \$5,413   |
| Trademarks                                 | 172,053   | (137,784 )               | 34,269    | 172,019   | (136,480 )               | 35,539    |
| Customer contracts and relationships       | 400,285   | (205,850 )               | 194,435   | 398,421   | (197,459 )               | 200,962   |
| Other intangibles                          | 52,503    | (39,166 )                | 13,337    | 51,265    | (34,127 )                | 17,138    |
| Total other intangible assets              | \$640,330 | \$ (393,222 )            | \$247,108 | \$636,473 | \$ (377,421 )            | \$259,052 |
| Purchased and other intangible assets, net | \$914,588 | \$ (466,972 )            | \$447,616 | \$896,671 | \$ (439,408 )            | \$457,263 |

Amortization expense related to purchased and other intangible assets was \$30.0 million and \$36.9 million for the three months ended March 4, 2011 and March 5, 2010, respectively. Of these amounts, \$19.7 million and \$18.7 million were included in cost of sales for the three months ended March 4, 2011 and March 5, 2010, respectively. As of March 4, 2011, we expect amortization expense in future periods to be as follows (in thousands):

| Fiscal Year                         | Purchased Technology | Other Intangible Assets |
|-------------------------------------|----------------------|-------------------------|
| Remainder of 2011                   | \$33,878             | \$43,758                |
| 2012                                | 44,080               | 30,389                  |
| 2013                                | 40,045               | 27,419                  |
| 2014                                | 37,032               | 26,420                  |
| 2015                                | 34,341               | 25,995                  |
| Thereafter                          | 11,132               | 93,127                  |
| Total expected amortization expense | \$200,508            | \$247,108               |

## NOTE 7. OTHER ASSETS

Other assets as of March 4, 2011 and December 3, 2010 consisted of the following (in thousands):

|                                   | 2011     | 2010     |
|-----------------------------------|----------|----------|
| Acquired rights to use technology | \$68,239 | \$71,521 |
| Investments                       | 22,581   | 25,018   |
| Deferred compensation plan assets | 13,148   | 11,071   |
| Prepaid land lease                | 13,175   | 13,215   |
| Security and other deposits       | 11,415   | 11,266   |
| Debt issuance costs               | 9,362    | 9,574    |
| Prepaid royalties                 | 6,623    | 7,726    |
| Restricted cash                   | 2,623    | 2,499    |
| Prepaid rent                      | 639      | 787      |
| Other <sup>(*)</sup>              | 16,996   | 17,194   |

|              |           |           |
|--------------|-----------|-----------|
| Other assets | \$164,801 | \$169,871 |
|--------------|-----------|-----------|

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(\*) Fiscal 2011 and 2010 includes a tax asset of approximately \$11.0 million related to an acquired entity.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Investments represent our direct investments in privately held companies which are accounted for based on the cost method. We assess these investments for impairment in value as circumstances dictate.

## NOTE 8. ACCRUED EXPENSES

Accrued expenses as of March 4, 2011 and December 3, 2010 consisted of the following (in thousands):

|                                   | 2011      | 2010      |
|-----------------------------------|-----------|-----------|
| Accrued compensation and benefits | \$165,912 | \$290,366 |
| Sales and marketing allowances    | 38,827    | 38,706    |
| Accrued marketing                 | 39,571    | 26,404    |
| Taxes payable                     | 24,289    | 21,800    |
| Accrued interest expense          | 5,811     | 21,203    |
| Other                             | 184,053   | 165,796   |
| Accrued expenses                  | \$458,463 | \$564,275 |

Other primarily includes general corporate accruals for local and regional expenses and technical support. Other is also comprised of deferred rent related to office locations with rent escalations, accrued royalties and foreign currency liability derivatives.

## NOTE 9. INCOME TAXES

The gross liability for unrecognized tax benefits at March 4, 2011 was \$163.5 million, exclusive of interest and penalties. If the total unrecognized tax benefits at March 4, 2011 were recognized in the future, \$147.3 million of unrecognized tax benefits would decrease the effective tax rate, which is net of an estimated \$16.2 million federal benefit related to deducting certain payments on future state tax returns.

As of March 4, 2011, the combined amount of accrued interest and penalties related to tax positions taken on our tax returns was approximately \$15.2 million. This amount is included in non-current income taxes payable.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of current and non-current assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from \$0 to approximately \$5 million. These amounts would decrease income tax expense.

## NOTE 10. STOCK-BASED COMPENSATION

The assumptions used to value option grants during the three months ended March 4, 2011 and March 5, 2010 were as follows:

|                          | 2011         | 2010         |
|--------------------------|--------------|--------------|
| Expected life (in years) | 3.8 - 4.1    | 3.8 - 4.1    |
| Volatility               | 31 - 35%     | 31 - 36%     |
| Risk free interest rate  | 1.46 - 1.92% | 1.76 - 1.97% |





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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The expected life of employee stock purchase plan (“ESPP”) shares is the average of the remaining purchase periods under each offering period. The assumptions used to value employee stock purchase rights during the three months ended March 4, 2011 and March 5, 2010 were as follows:

|                          |              |              |
|--------------------------|--------------|--------------|
|                          | 2011         | 2010         |
| Expected life (in years) | 0.5 - 2.0    | 0.5 - 2.0    |
| Volatility               | 32 - 34%     | 32%          |
| Risk free interest rate  | 0.19 - 0.61% | 0.18 - 1.09% |

## Summary of Stock Options

Option activity for the three months ended March 4, 2011 and the fiscal year ended December 3, 2010 was as follows (in thousands):

|                               |        |          |
|-------------------------------|--------|----------|
|                               | 2011   | 2010     |
| Beginning outstanding balance | 37,075 | 41,251   |
| Granted                       | 4,095  | 3,198    |
| Exercised                     | (2,244 | ) (5,196 |
| Cancelled                     | (527   | ) (2,908 |
| Increase due to acquisition   | 130    | 730      |
| Ending outstanding balance    | 38,529 | 37,075   |

Information regarding stock options outstanding at March 4, 2011 and March 5, 2010 is summarized below:

|                                     | Number of<br>Shares<br>(thousands) | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Life<br>(years) | Aggregate<br>Intrinsic<br>Value <sup>(*)</sup><br>(millions) |
|-------------------------------------|------------------------------------|--|--|--|
| 2011                                |                                    |  |  |  |
| Options outstanding                 | 38,529                             | \$31.18                                  | 3.80   | \$203.1  |
| Options vested and expected to vest | 36,857                             | \$31.22                                  | 3.70   | \$194.6  |
| Options exercisable                 | 26,948                             | \$31.92                                  | 2.95   | \$133.1  |
| 2010                                |                                    |  |  |  |
| Options outstanding                 | 41,356                             | \$30.27                                  | 4.29   | \$254.7  |
| Options vested and expected to vest | 39,258                             | \$30.32                                  | 4.19   | \$241.2  |
| Options exercisable                 | 26,270                             | \$30.55                                  | 3.39   | \$158.9  |

(\*) The intrinsic value is calculated as the difference between the market value as of the end of the fiscal period and the exercise price of the shares. As reported by the NASDAQ Global Select Market, the market values as of March 4, 2011 and March 5, 2010 were \$35.27 and \$35.16, respectively.

## Summary of Employee Stock Purchase Plan Shares

Employees purchased 1.4 million shares at an average price of \$20.61 and 1.3 million shares at an average price of \$20.20 for the three months ended March 4, 2011 and March 5, 2010, respectively. The intrinsic value of shares purchased during the three months ended March 4, 2011 and March 5, 2010 was \$15.3 million and \$21.4 million,

respectively. The intrinsic value is calculated as the difference between the market value on the date of purchase and the purchase price of the shares.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## Summary of Restricted Stock Units

Restricted stock unit activity for the three months ended March 4, 2011 and the fiscal year ended December 3, 2010 was as follows (in thousands):

|                               |        |          |   |
|-------------------------------|--------|----------|---|
|                               | 2011   | 2010     |   |
| Beginning outstanding balance | 13,890 | 10,433   |   |
| Awarded                       | 6,831  | 7,340    |   |
| Released                      | (2,567 | ) (2,589 | ) |
| Forfeited                     | (290   | ) (1,294 | ) |
| Increase due to acquisition   | 59     | —        |   |
| Ending outstanding balance    | 17,923 | 13,890   |   |

Information regarding restricted stock units outstanding at March 4, 2011 and March 5, 2010 is summarized below:

|  | Number of<br>Shares<br>(thousands) | Weighted<br>Average<br>Remaining<br>Contractual<br>Life<br>(years) | Aggregate<br>Intrinsic<br>Value <sup>(*)</sup><br>(millions) |
|--|------------------------------------|--|--|
| 2011   |                                    |  |  |
| Restricted stock units outstanding                 | 17,923                             | 1.92   | \$632.1  |
| Restricted stock units vested and expected to vest | 13,661                             | 1.75   | \$481.1  |
| 2010   |                                    |  |  |
| Restricted stock units outstanding                 | 14,142                             | 2.08   | \$497.2  |
| Restricted stock units vested and expected to vest | 10,527                             | 1.90   | \$369.8  |

(\*) The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ Global Select Market, the market values as of March 4, 2011 and March 5, 2010 were \$35.27 and \$35.16, respectively.

## Summary of Performance Shares

Effective January 24, 2011, the Executive Compensation Committee adopted the 2011 Performance Share Program (the "2011 Program"). The purpose of the 2011 Program is to align key management and senior leadership with stockholders' interests and to retain key employees. The measurement period for the 2011 Program is our fiscal 2011 year. All members of our executive management and other key senior management are participating in the 2011 Program. Awards granted under the 2011 Program are granted in the form of performance shares pursuant to the terms of our 2003 Equity Incentive Plan. If pre-determined performance goals are met, shares of stock will be granted to the recipient, with one third vesting on the later of the date of certification of achievement or the first anniversary date of the grant, and the remaining two thirds vesting evenly on the following two annual anniversary dates of the grant, contingent upon the recipient's continued service to Adobe. Participants in the 2011 Program have the ability to receive up to 150% of the target number of shares originally granted.

The following table sets forth the summary of performance share activity under our 2011 Program for the three months ended March 4, 2011 (in thousands):

|        |         |
|--------|---------|
| Shares | Maximum |
|--------|---------|

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|                               | Granted | Shares Eligible<br>to Receive |
|-------------------------------|---------|-------------------------------|
| Beginning outstanding balance | —       | —                             |
| Awarded                       | 425     | 638                           |
| Forfeited                     | —       | —                             |
| Ending outstanding balance    | 425     | 638                           |

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In the first quarter of fiscal 2011, the Executive Compensation Committee certified the actual performance achievement of participants in the 2010 Performance Share Program (the "2010 Program"). Based upon the achievement of goals outlined in the 2010 Program, participants had the ability to receive up to 150% of the target number of shares originally granted. Actual performance resulted in participants achieving 135% of target or approximately 0.3 million shares for the 2010 Program. One third of the shares under the 2010 Program vested in the first quarter of fiscal 2011 and the remaining two thirds vest evenly on the following two annual anniversary dates of the grant, contingent upon the recipient's continued service to Adobe.

The performance metrics under the 2009 Performance Share Program were not achieved and therefore no shares were awarded.

The following table sets forth the summary of performance share activity under our 2007, 2008 and 2010 programs, based upon share awards actually achieved, for the three months ended March 4, 2011 and the fiscal year ended December 3, 2010 (in thousands):

|                               |      |        |   |
|-------------------------------|------|--------|---|
|                               | 2011 | 2010   |   |
| Beginning outstanding balance | 557  | 950    |   |
| Achieved                      | 337  | —      |   |
| Released                      | (415 | ) (350 | ) |
| Forfeited                     | (10  | ) (43  | ) |
| Ending outstanding balance    | 469  | 557    |   |

Information regarding performance shares outstanding at March 4, 2011 and March 5, 2010 is summarized below:

|  | Number of<br>Shares<br>(thousands) | Weighted<br>Average<br>Remaining<br>Contractual<br>Life<br>(years) | Aggregate<br>Intrinsic<br>Value <sup>(*)</sup><br>(millions) |
|--|------------------------------------|--|--|
| 2011   |                                    |  |  |
| Performance shares outstanding                 | 469                                | 1.11   | \$16.6   |
| Performance shares vested and expected to vest | 401                                | 1.08   | \$13.9   |
| 2010   |                                    |  |  |
| Performance shares units outstanding           | 607                                | 1.28   | \$21.3   |
| Performance shares vested and expected to vest | 505                                | 1.23   | \$17.6   |

(\*) The intrinsic value is calculated as the market value as of the end of the fiscal period. As reported by the NASDAQ Global Select Market, the market values as of March 4, 2011 and March 5, 2010 were \$35.27 and \$35.16, respectively.

**Compensation Costs**

As of March 4, 2011, there was \$517.1 million of unrecognized compensation cost, adjusted for estimated forfeitures, related to non-vested stock-based awards which will be recognized over a weighted average period of 2.9 years. Total

unrecognized compensation cost will be adjusted for future changes in estimated forfeitures.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Total stock-based compensation costs that have been included in our Condensed Consolidated Statements of Income for the three months ended March 4, 2011 and March 5, 2010 were as follows (in thousands):

| Income Statement<br>Classifications  | 2011  |   | 2010  |   |
|--------------------------------------|---|---|---|---|
|                                      | Option<br>Grants<br>and Stock<br>Purchase<br>Rights | Restricted<br>Stock and<br>Performance<br>Share<br>Awards | Option<br>Grants<br>and Stock<br>Purchase<br>Rights | Restricted<br>Stock and<br>Performance<br>Share<br>Awards |
| Cost of revenue—subscription         | \$ 192  | \$ 321  | \$—   | \$—   |
| Cost of revenue—services and support | 1,095   | 2,075   | 417   | 531   |
| Research and development             | 6,755   | 20,578  | 12,054  | 15,361  |
| Sales and marketing                  | 7,550   | 16,416  | 12,086  | 12,435  |
| General and administrative           | 5,949   | 10,061  | 5,610   | 5,986   |
| Total                                | \$21,541  | \$49,451  | \$30,167  | \$34,313  |

## NOTE 11. RESTRUCTURING CHARGES

## Fiscal 2009 Restructuring Plan

In the fourth quarter of fiscal 2009, in order to appropriately align our costs in connection with our fiscal 2010 operating plan, we initiated a restructuring plan consisting of reductions in workforce and the consolidation of facilities. The restructuring activities related to this program affected only those employees and facilities that were associated with Adobe prior to the acquisition of Omniture on October 23, 2009.

Total costs incurred for termination benefits through the first quarter of fiscal 2011 was \$40.0 million. Total costs incurred to date and expected to be incurred for closing redundant facilities are \$8.9 million and \$12.6 million, respectively.

## Omniture Restructuring Plan

We completed our acquisition of Omniture on October 23, 2009. In the fourth quarter of fiscal 2009, we initiated a plan to restructure the pre-merger operations of Omniture to eliminate certain duplicative activities, focus our resources on future growth opportunities and reduce our cost structure. In connection with this restructuring plan, we accrued a total of approximately \$11.8 million in costs related to termination benefits, the closure of duplicative facilities and cancellation of certain contracts associated with the wind-down of subsidiaries and other service contracts held by Omniture through the first quarter of fiscal 2011. Substantially all of these costs were recorded as a part of the purchase price allocation.

## Fiscal 2008 Restructuring Plan

In the fourth quarter of fiscal 2008, we initiated a restructuring program consisting of reductions in workforce and the consolidation of facilities, in order to reduce our operating costs and focus our resources on key strategic priorities. In connection with the restructuring plan, we recognized costs related to termination benefits for employee positions that were eliminated and for the closure of duplicative facilities. Total costs incurred to date for termination benefits was \$35.2 million and was completed during the first quarter of fiscal 2011. Total costs incurred to date and expected to be incurred for closing redundant facilities are \$8.7 million and \$8.8 million, respectively.

## Macromedia Restructuring Plan

We completed our acquisition of Macromedia on December 3, 2005. In connection with this acquisition, we initiated plans to restructure both the pre-merger operations of Adobe and Macromedia to eliminate certain duplicative



activities, focus our resources on future growth opportunities and reduce our cost structure. In connection with the worldwide restructuring plan, we recognized costs related to termination benefits for employee positions that were eliminated and for the closure of duplicative facilities. We also recognized costs related to the cancellation of certain contracts associated with the wind-down of subsidiaries and other service contracts held by Macromedia. Total costs incurred for termination benefits and contract terminations were \$27.0 million and \$3.2 million, respectively, and those actions were completed during fiscal 2007.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## Summary of Restructuring Plans

The following table sets forth a summary of restructuring activities related to all of our restructuring plans described above during the three months ended March 4, 2011 (in thousands):

|                                      | December 3,<br>2010 | Costs<br>Incurred | Cash<br>Payments | Other<br>Adjustments | March 4,<br>2011 |
|--------------------------------------|---------------------|-------------------|------------------|----------------------|------------------|
| Fiscal 2009 Plan:                    |                     |                   |                  |                      |                  |
| Termination benefits                 | \$1,573             | \$—               | \$(297           | ) \$(41              | ) \$1,235        |
| Cost of closing redundant facilities | 7,302               | —                 | (1,055           | ) 199                | 6,446            |
| Omnicure Plan:                       |                     |                   |                  |                      |                  |
| Termination benefits                 | 486                 | —                 | —                | 21                   | 507              |
| Cost of closing redundant facilities | 2,720               | —                 | (444             | ) 15                 | 2,291            |
| Contract termination                 | 179                 | —                 | —                | —                    | 179              |
| Fiscal 2008 Plan:                    |                     |                   |                  |                      |                  |
| Termination benefits                 | 300                 | —                 | (164             | ) (136               | ) —              |
| Cost of closing redundant facilities | 2,149               | —                 | (99              | ) 203                | 2,253            |
| Macromedia Plan:                     |                     |                   |                  |                      |                  |
| Cost of closing redundant facilities | 1,658               | —                 | (504             | ) —                  | 1,154            |
| Other                                | 6                   | —                 | (5               | ) —                  | 1                |
| Total restructuring plans            | \$16,373            | \$—               | \$(2,568         | ) \$261              | \$14,066         |

Accrued restructuring charges of approximately \$14.1 million at March 4, 2011 includes \$6.8 million recorded in accrued restructuring, current and \$7.3 million related to long-term facilities obligations recorded in accrued restructuring, non-current on our Condensed Consolidated Balance Sheets. We expect to pay accrued termination benefits through the second quarter of fiscal 2011 and facilities-related liabilities under contract through fiscal 2021.

## NOTE 12. STOCKHOLDERS' EQUITY

## Retained Earnings

The changes in retained earnings for the three months ended March 4, 2011 were as follows (in thousands):

|                                |             |
|--------------------------------|-------------|
| Balance as of December 3, 2010 | \$5,980,914 |
| Net income                     | 234,591     |
| Re-issuance of treasury stock  | (169,874    |
| Balance as of March 4, 2011    | \$6,045,631 |

We account for treasury stock under the cost method. When treasury stock is re-issued at a price higher than its cost, the difference is recorded as a component of additional paid-in-capital in our Condensed Consolidated Balance Sheets. When treasury stock is re-issued at a price lower than its cost, the difference is recorded as a component of additional paid-in-capital to the extent that there are gains to offset the losses. If there are no treasury stock gains in additional paid-in-capital, the losses upon re-issuance of treasury stock are recorded as a component of retained earnings in our Condensed Consolidated Balance Sheets.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## Comprehensive Income

The following table sets forth the activity for each component of comprehensive income, net of related taxes, for the three months ended March 4, 2011 and March 5, 2010 (in thousands):

|   | 2011                | 2010      |
|---|---------------------|-----------|
|   | Increase/(decrease) |           |
| Net income  | \$234,591           | \$127,154 |
| Other comprehensive income:   |                     |           |
| Available-for-sale securities:  |                     |           |
| Unrealized gains on available-for-sale securities   | (53                 | ) (758    |
| Reclassification adjustment for gains on available-for-sale securities recognized during the period | (544                | ) (344    |
| Subtotal available-for-sale securities  | (597                | ) (1,102  |
| Derivatives designated as hedging instruments:  |                     |           |
| Unrealized gains on derivative instruments  | (67                 | ) 10,364  |
| Reclassification adjustment for gains on derivative instruments recognized during the period        | —                   | —         |
| Subtotal derivatives designated as hedging instruments  | (67                 | ) 10,364  |
| Foreign currency translation adjustments  | 11,931              | (4,599    |
| Other comprehensive income  | 11,267              | 4,663     |
| Total comprehensive income, net of taxes  | \$245,858           | \$131,817 |

The following table sets forth the components of accumulated other comprehensive income, net of related taxes, as of March 4, 2011 and December 3, 2010 (in thousands):

|  | 2011     | 2010     |
|--|----------|----------|
| Net unrealized gains on available-for-sale securities:                           |          |          |
| Unrealized gains on available-for-sale securities                                | \$11,430 | \$12,138 |
| Unrealized losses on available-for-sale securities                               | (2,382   | ) (2,493 |
| Total net unrealized gains on available-for-sale securities                      | 9,048    | 9,645    |
| Net unrealized gains on derivative instruments designated as hedging instruments | 84       | 151      |
| Cumulative foreign currency translation adjustments                              | 19,563   | 7,632    |
| Total accumulated other comprehensive income, net of taxes                       | \$28,695 | \$17,428 |

## Stock Repurchase Program

To facilitate our stock repurchase program, designed to return value to our stockholders and minimize dilution from stock issuances, we repurchase shares in the open market and also enter into structured repurchases with third-parties. During the third quarter of fiscal 2010, our Board of Directors approved an amendment to our stock repurchase program authorized in April 2007 from a non-expiring share-based authority to a time-constrained dollar-based authority. As part of this amendment, the Board of Directors granted authority to repurchase up to \$1.6 billion in common stock through the end of fiscal 2012.

During the three months ended March 4, 2011, we entered into a structured stock repurchase agreement with a large financial institution, whereupon we provided them with a prepayment of \$125.0 million. We did not enter into any new structured repurchase agreements during the three months ended March 5, 2010. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price (“VWAP”) of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than the foregone return on our cash



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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. During the three months ended March 4, 2011, we repurchased approximately 2.5 million shares at an average price of \$32.84 through structured repurchase agreements entered into during the three months ended March 4, 2011. During the three months ended March 5, 2010, we repurchased approximately 1.7 million shares at an average price of \$36.21 through structured repurchase agreements entered into during fiscal 2009. As of March 4, 2011 and December 3, 2010, the prepayments were classified as treasury stock on our Condensed Consolidated Balance Sheets at the payment date, though only shares physically delivered to us by the financial statement date were excluded from the computation of earnings per share. As of March 4, 2011, approximately \$41.6 million of payments remained under these agreements. As of March 5, 2010, there were no up-front payments remaining under the agreements.

Subsequent to March 4, 2011, as part of our \$1.6 billion stock repurchase program, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of \$420.0 million. This amount will be classified as treasury stock on our Condensed Consolidated Balance Sheets. Upon completion of the \$420.0 million stock repurchase agreement, \$455.0 million remains under our time-constrained dollar-based authority. See Note 18 for further discussion of our stock repurchase program.

## NOTE 13. NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share for the three months ended March 4, 2011 and March 5, 2010 (in thousands, except per share data):

|  | 2011      | 2010      |
|--|-----------|-----------|
| Net income   | \$234,591 | \$127,154 |
| Shares used to compute basic net income per share      | 504,134   | 524,173   |
| Dilutive potential common shares:                      |           |           |
| Unvested restricted stock and performance share awards | 3,764     | 3,078     |
| Stock options  | 3,447     | 5,394     |
| Shares used to compute diluted net income per share    | 511,345   | 532,645   |
| Basic net income per share                             | \$0.47    | \$0.24    |
| Diluted net income per share                           | \$0.46    | \$0.24    |

For the three months ended March 4, 2011, options to purchase approximately 21.9 million shares of common stock with exercise prices greater than the average fair market value of our stock of \$32.35 were not included in the calculation because the effect would have been anti-dilutive. Comparatively, for the three months ended March 5, 2010, options to purchase approximately 17.5 million shares of common stock with exercise prices greater than the average fair market value of our stock of \$35.13 were not included in the calculation because the effect would have been anti-dilutive.

## NOTE 14. COMMITMENTS AND CONTINGENCIES

Lease Commitments

We occupy three office buildings in San Jose, California where our corporate headquarters are located. We reference these office buildings as the Almaden Tower and the East and West Towers.

In August 2004, we extended the lease agreement for our East and West Towers for an additional five years with an option to extend for an additional five years solely at our election. In June 2009, we submitted notice to the lessor that we intended to exercise our option to renew this agreement for an additional five years effective August 2009. As stated in the original lease agreement, in conjunction with the lease renewal, we were required to obtain a standby letter of credit for approximately \$16.5

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

million which enabled us to secure a lower interest rate and reduce the number of covenants. As defined in the lease agreement, the standby letter of credit primarily represents the lease investment equity balance which is callable in the event of default. In March 2007, the Almaden Tower lease was extended for five years, with a renewal option for an additional five years solely at our election. As part of the lease extensions, we purchased the lease receivable from the lessor of the East and West Towers for \$126.8 million and a portion of the lease receivable from the lessor of the Almaden Tower for \$80.4 million, both of which are recorded as investments in lease receivables on our Condensed Consolidated Balance Sheets. As of March 4, 2011, the carrying value of the lease receivables related to all three towers approximated fair value. This purchase may be credited against the residual value guarantee if we purchase the properties or will be repaid from the sale proceeds if the properties are sold to third-parties. Under the agreement for the East and West Towers and the agreement for the Almaden Tower, we have the option to purchase the buildings at anytime during the lease term for approximately \$143.2 million and \$103.6 million, respectively. The residual value guarantees under the East and West Towers and the Almaden Tower obligations are \$126.8 million and \$89.4 million, respectively.

These two leases are both subject to standard covenants including certain financial ratios that are reported to the lessors quarterly. As of March 4, 2011, we were in compliance with all of the covenants. In the case of a default, the lessor may demand we purchase the buildings for an amount equal to the lease balance, or require that we remarket or relinquish the buildings. Both leases qualify for operating lease accounting treatment and, as such, the buildings and the related obligations are not included on our Condensed Consolidated Balance Sheets. We utilized this type of financing in order to access bank-provided funding at the most favorable rates and to provide the lowest total cost of occupancy for the headquarter buildings. At the end of the lease term, we can extend the lease for an additional five year term, purchase the buildings for the lease balance, remarket or relinquish the buildings. If we choose to remarket or are required to do so upon relinquishing the buildings, we are bound to arrange the sale of the buildings to an unrelated party and will be required to pay the lessor any shortfall between the net remarketing proceeds and the lease balance, up to the residual value guarantee amount.

In June 2010, we entered into a sale-leaseback agreement to sell equipment totaling \$32.2 million and leaseback the same equipment over a period of 43 months. This transaction was classified as a capital lease obligation and recorded at fair value. See Note 15 for further discussion of our capital lease obligation.

**Guarantees**

The lease agreements for our corporate headquarters provide for residual value guarantees as noted above. The fair value of a residual value guarantee in lease agreements entered into after December 31, 2002, must be recognized as a liability on our Condensed Consolidated Balance Sheets. As such, we recognized \$5.2 million and \$3.0 million in liabilities, related to the extended East and West Towers and Almaden Tower leases, respectively. These liabilities are recorded in other long-term liabilities with the offsetting entry recorded as prepaid rent in other assets. The balance will be amortized to the income statement over the life of the leases. As of March 4, 2011 and December 3, 2010, the unamortized portion of the fair value of the residual value guarantees, for both leases, remaining in other long-term liabilities and prepaid rent was \$0.6 million and \$0.7 million, respectively.

**Royalties**

We have royalty commitments associated with the shipment and licensing of certain products. Royalty expense is generally based on a dollar amount per unit shipped or a percentage of the underlying revenue.

**Indemnifications**

In the ordinary course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third-parties arising from the use of our products. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum

potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our officers and directors for certain events or occurrences while the officer or director is, or was serving, at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director



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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

and officer insurance coverage that reduces our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

During fiscal 2010, our limited partnership interest in Adobe Ventures was dissolved and all remaining assets were distributed to the partners. As part of this limited partnership interest, we provided a general indemnification to Granite Ventures, an independent venture capital firm and sole general partner of Adobe Ventures, for certain events or occurrences while Granite Ventures was serving at our request in such capacity provided that Granite Ventures acted in good faith on behalf of the partnership.

**Legal Proceedings**

In October 2009, Eolas Technologies Incorporated filed a complaint against us and 22 other companies for patent infringement in the United States District Court for the Eastern District of Texas. The complaint alleges, among other things, that a number of our Web pages and products infringe two patents owned by plaintiff purporting to cover “Distributed Hypermedia Method for Automatically Invoking External Application Providing Interaction and Display of Embedded Objects within a Hypermedia Document” (U.S. Patent No. 5,838,906) and “Distributed Hypermedia Method and System for Automatically Invoking External Application Providing Interaction and Display of Embedded Objects within a Hypermedia Document” (U.S. Patent No. 7,599,985) and seeks injunctive relief, monetary damages, costs and attorneys fees. We dispute these claims and intend to vigorously defend ourselves in this matter. As of March 4, 2011, no amounts have been accrued as a loss is not probable or estimable.

In connection with our anti-piracy efforts, conducted both internally and through organizations such as the Business Software Alliance, from time to time we undertake litigation against alleged copyright infringers. Such lawsuits may lead to counter-claims alleging improper use of litigation or violation of other local laws. We believe we have valid defenses with respect to such counter-claims; however, it is possible that our consolidated financial position, cash flows or results of operations could be affected in any particular period by the resolution of one or more of these counter-claims.

Adobe is subject to legal proceedings, claims and investigations in the ordinary course of business, including claims of alleged infringement of third-party patents and other intellectual property rights, indemnification claims, commercial, employment and other matters. Adobe makes a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, settlements, rulings, advice of legal counsel and other information and events pertaining to a particular case. All legal costs associated with litigation are expensed as incurred. Litigation is inherently unpredictable. However, we believe that we have valid defenses with respect to the legal matters pending against Adobe. It is possible, nevertheless, that our consolidated financial position, cash flows or results of operations could be negatively affected by an unfavorable resolution of one or more of such proceedings, claims or investigations.

**NOTE 15. DEBT**

Our debt as of March 4, 2011 and December 3, 2010 consisted of the following (in thousands):

|  | 2011        | 2010        |
|--|-------------|-------------|
| Notes                                    | \$1,494,130 | \$1,493,969 |
| Credit facility                          | —           | —           |
| Capital lease obligations                | 26,323      | 28,492      |
| Total debt and capital lease obligations | 1,520,453   | 1,522,461   |

|                                    |             |             |
|------------------------------------|-------------|-------------|
| Less: current portion              | 8,900       | 8,799       |
| Debt and capital lease obligations | \$1,511,553 | \$1,513,662 |
| Notes                              |             |             |

In February 2010, we issued \$600.0 million of 3.25% senior notes due February 1, 2015 (the “2015 Notes”) and \$900.0 million of 4.75% senior notes due February 1, 2020 (the “2020 Notes” and, together with the 2015 Notes, the “Notes”). Our proceeds were approximately \$1.5 billion and were net of an issuance discount of \$6.6 million. The Notes rank equally with our other unsecured and unsubordinated indebtedness. In addition, we incurred issuance costs of approximately \$10.7 million. Both

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ADOBE SYSTEMS INCORPORATED

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

the discount and issuance costs are being amortized to interest expense over the respective terms of the Notes using the effective interest method. The effective interest rate including the discount and issuance costs is 3.45% for the 2015 Notes and 4.92% for the 2020 Notes. Interest is payable semi-annually, in arrears, on February 1 and August 1, commencing on August 1, 2010. In February 2011, we made a semi-annual interest payment of \$31.1 million. The proceeds from the Notes are available for general corporate purposes, including repayment of any balance outstanding on our credit facility. Based on quoted market prices, the fair value of the Notes was approximately \$1.5 billion as of March 4, 2011.

We may redeem the Notes at any time, subject to a make whole premium. In addition, upon the occurrence of certain change of control triggering events, we may be required to repurchase the Notes, at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the date of repurchase. The Notes also include covenants that limit our ability to grant liens on assets and to enter into sale and leaseback transactions, subject to significant allowances. As of March 4, 2011, we were in compliance with all of the covenants.

Credit Agreement

In August 2007, we entered into an Amendment to our Credit Agreement dated February 2007 (the "Amendment"), which increased the total senior unsecured revolving facility from \$500.0 million to \$1.0 billion. The Amendment also permits us to request one-year extensions effective on each anniversary of the closing date of the original agreement, subject to the majority consent of the lenders. We also retain an option to request an additional \$500.0 million in commitments, for a maximum aggregate facility of \$1.5 billion.

In February 2008, we entered into a Second Amendment to the Credit Agreement dated February 26, 2008, which extended the maturity date of the facility by one year to February 16, 2013. The facility would terminate at this date if no additional extensions have been requested and granted. All other terms and conditions remain the same.

The facility contains a financial covenant requiring us not to exceed a certain maximum leverage ratio. At our option, borrowings under the facility accrue interest based on either the London interbank offered rate ("LIBOR") for one, two, three or six months, or longer periods with bank consent, plus a margin according to a pricing grid tied to this financial covenant, or a base rate. The margin is set at rates between 0.20% and 0.475%. Commitment fees are payable on the facility at rates between 0.05% and 0.15% per year based on the same pricing grid. The facility is available to provide loans to us and certain of our subsidiaries for general corporate purposes. On February 1, 2010, we paid the outstanding balance on our credit facility and the entire \$1.0 billion credit line under this facility remains available for borrowing.

Capital Lease Obligation

In June 2010, we entered into a sale-leaseback agreement to sell equipment totaling \$32.2 million and leaseback the same equipment over a period of 43 months. This transaction was classified as a capital lease obligation and recorded at fair value. As of March 4, 2011, our capital lease obligations of \$26.3 million includes \$8.9 million of current debt.

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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

## NOTE 16. NON-OPERATING INCOME (EXPENSE)

Non-operating income (expense) for the three months ended March 4, 2011 and March 5, 2010 included the following (in thousands):

|  | 2011      | 2010        |
|--|-----------|-------------|
| Interest and other income (expense), net:  |           |             |
| Interest income                            | \$6,099   | \$5,105     |
| Foreign exchange gains (losses)            | (7,774    | ) (5,084    |
| Realized gains on fixed income investment  | 605       | 342         |
| Realized losses on fixed income investment | (61       | ) —         |
| Other                                      | 314       | 248         |
| Interest and other income (expense), net   | \$(817    | ) \$611     |
| Interest expense                           | \$(17,020 | ) \$(7,695  |
| Investment gains (losses), net:            |           |             |
| Realized investment gains                  | \$1,802   | \$183       |
| Unrealized investment gains                | 438       | 222         |
| Realized investment losses                 | (650      | ) (405      |
| Unrealized investment losses               | —         | (3,534      |
| Investment gains (losses), net             | \$1,590   | \$(3,534    |
| Non-operating income (expense), net        | \$(16,247 | ) \$(10,618 |

## NOTE 17. SEGMENTS

We have the following reportable segments:

**Creative and Interactive Solutions**—Our Creative and Interactive Solutions segment focuses on delivering a complete professional line of integrated tools for a full range of design and publishing and developer tasks to an extended set of customers.

**Digital Media Solutions**—Our Digital Media Solutions segments contains our professional imaging and video products and focuses on many of the same creative professional customers as our Creative and Interactive Solutions business.

**Knowledge Worker**—Our Knowledge Worker segment focuses on the needs of knowledge worker customers, providing essential applications and services to help them share information and collaborate. This segment contains our Acrobat family of products.

**Enterprise**—Our Enterprise segment provides server-based Customer Experience Management Solutions to enterprise and government customers to optimize their information intensive customer-facing processes and improve the overall customer experience of their constituents. This segment contains our Adobe Connect, Day and LiveCycle lines of products.

**Omniure**—Our Omniure segment provides web analytics and online business optimization products and services to manage and enhance online, offline and multi-channel marketing initiatives.

**Print and Publishing**—Our Print and Publishing segment addresses market opportunities ranging from the diverse publishing needs of technical and business publishing to our legacy type and OEM printing businesses.



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## ADOBE SYSTEMS INCORPORATED

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Effective in the first quarter of fiscal 2011, we modified our segments due to changes in how we operate our business. We split our prior Creative Solutions segment into two new segments: Creative and Interactive Solutions and Digital Media Solutions. Creative and Interactive Solutions contains our Creative Suite family of products including our professional page layout and Web layout products, whereas Digital Media Solutions contains our imaging and video products for professionals and hobbyists. We also merged our former Platform segment into the new Creative and Interactive Solutions segment to better align our focus with market trends and our opportunities. In addition to our business unit reorganization, we moved several products to different businesses. Our Scene7 products were moved from our Creative Solutions business to our Omniture business; our ColdFusion products were moved from our Platform business to our Print and Publishing business; and our Adobe Presenter product that was part of our Adobe Connect offering was moved from our Enterprise business to our Print and Publishing business. Prior year information in the table below has been reclassified to reflect these changes.

We report segment information based on the “management” approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reportable segments.

Our chief operating decision maker reviews revenue and gross margin information for each of our reportable segments. Operating expenses are not reviewed on a segment by segment basis. In addition, with the exception of goodwill and intangible assets, we do not identify or allocate our assets by the reportable segments.

| (in thousands)                                | Creative and<br>Interactive<br>Solutions | Digital<br>Media<br>Solutions | Knowledge<br>Worker | Enterprise | Omniture  | Print and<br>Publishing | Total       |   |
|---|--|-------------------------------|---------------------|------------|-----------|-------------------------|-------------|---|
| Three months<br>ended<br>March 4, 2011        |  |                               |                     |            |           |                         |             |   |
| Revenue                                       | \$424,828                                | \$151,654                     | \$181,843           | \$104,821  | \$110,864 | \$53,696                | \$1,027,706 |   |
| Cost of revenue                               | 15,091                                   | 9,766                         | 5,814               | 26,487     | 47,819    | 2,662                   | 107,639     |   |
| Gross profit                                  | \$409,737                                | \$141,888                     | \$176,029           | \$78,334   | \$63,045  | \$51,034                | \$920,067   |   |
| Gross profit as a<br>percentage<br>of revenue | 96                                       | % 94                          | % 97                | % 75       | % 57      | % 95                    | % 90        | % |
| Three months<br>ended<br>March 5, 2010        |  |                               |                     |            |           |                         |             |   |
| Revenue                                       | \$332,558                                | \$130,618                     | \$165,862           | \$78,886   | \$95,990  | \$54,786                | \$858,700   |   |
| Cost of revenue                               | 12,427                                   | 8,937                         | 4,641               | 15,483     | 45,081    | 2,799                   | 89,368      |   |
| Gross profit                                  | \$320,131                                | \$121,681                     | \$161,221           | \$63,403   | \$50,909  | \$51,987                | \$769,332   |   |
| Gross profit as a<br>percentage<br>of revenue | 96                                       | % 93                          | % 97                | % 80       | % 53      | % 95                    | % 90        | % |

## NOTE 18. SUBSEQUENT EVENTS

Subsequent to March 4, 2011, as part of our \$1.6 billion stock repurchase program, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of \$420.0

million. This amount will be classified as treasury stock on our Condensed Consolidated Balance Sheets. Upon completion of the \$420.0 million stock repurchase agreement, \$455.0 million remains under our time-constrained dollar-based authority. See Note 12 for further discussion of our stock repurchase program.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and Notes thereto.

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements, including statements regarding product plans, future growth and market opportunities, which involve risks and uncertainties that could cause actual results to differ materially from these forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Risk Factors" in Part II, Item 1A of this report. You should carefully review the risks described herein and in other documents we file from time to time with the Securities and Exchange Commission (the "SEC"), including our Annual Report on Form 10-K for fiscal 2010. When used in this report, the words "expects," "could," "would," "may," "anticipates," "intends," "plans," "believes," "seeks," "targets," "estimates," "looks for," "looks to" and similar expressions, as well as statements regarding our focus for the future, are generally intended to identify forward-looking statements. You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.

**BUSINESS OVERVIEW**

Founded in 1982, Adobe Systems Incorporated is one of the largest and most diversified software companies in the world. We offer a line of creative, business, Web and mobile software and services used by creative professionals, knowledge workers, developers, marketers, enterprises and consumers for creating, managing, delivering, optimizing and engaging with compelling content and experiences across multiple operating systems, devices and media. We distribute our products through a network of distributors, value-added resellers ("VARs"), systems integrators, independent software vendors ("ISVs") and original equipment manufacturers ("OEMs"). We also market and license our software directly to enterprise customers through our sales force and to end users and through our own Website at [www.adobe.com](http://www.adobe.com). In addition, we license our technology to hardware manufacturers, software developers and service providers, and provide some of our solutions via Software as a Service ("SaaS"), also known as hosted or "cloud-based" offerings. Our software runs on personal computers ("PC") and server-based computers, as well as various non-PC and mobile devices, depending on the product. We have operations in the Americas, Europe, Middle East and Africa ("EMEA") and Asia.

We maintain executive offices and principal facilities at 345 Park Avenue, San Jose, California 95110-2704. Our telephone number is 408-536-6000. We maintain a Website at [www.adobe.com](http://www.adobe.com). Investors can obtain copies of our SEC filings from this site free of charge, as well as from the SEC Website at [www.sec.gov](http://www.sec.gov).

**OPERATIONS OVERVIEW**

Effective in the first quarter of fiscal 2011, we modified our segments due to changes in how we operate our business. We split our prior Creative Solutions segment into two new segments: Creative and Interactive Solutions and Digital Media Solutions. Creative and Interactive Solutions contains our Creative Suite family of products including our professional page layout and Web layout products, whereas Digital Media Solutions contains our imaging and video products for professionals and hobbyists. We also merged our former Platform segment into the new Creative and Interactive Solutions segment to better align our focus with market trends and our opportunities. As part of our business unit reorganization, we also moved several products to different businesses. See Note 17 of our Notes to Condensed Consolidated Financial Statements for further information. Prior year information has been updated to reflect these changes.

For our first quarter of fiscal 2011, we reported record revenue with strong financial results. Our performance was driven by strong adoption of our solutions across three strategic growth initiatives we are focused on: Content Authoring, Customer Experience Management ("CEM"), and Online Marketing.



For comparative purposes, financial results for the three months ended March 5, 2010 benefited from an extra week in the quarter due to our 52/53 week financial calendar. This extra week had a favorable impact on our revenue in the year-ago quarter by approximately \$35 million and related impact to expenses of approximately \$20 million. Fiscal 2010 was a 53-week year, whereas fiscal 2011 is a 52-week year and our first quarter of fiscal 2011 contained one less week.

In our Creative and Interactive Solutions segment, broad adoption of Adobe Creative Suite 5 ("CS5") family of products continued to drive the overall performance of our creative business. This resulted in 28% year-over-year growth in the segment.

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Our Digital Media Solutions segment achieved 16% year-over-year growth, benefiting from the adoption of our CS5 image editing and video-authoring products during the quarter.

Our Knowledge Worker segment achieved 10% year-over-year growth due to continued demand for our Acrobat X product which was released in the fourth quarter of fiscal 2010.

Our Enterprise segment also achieved strong year-over-year growth of 33%. We believe our increased investment in this business over the past several years, including our acquisition of Day Software Holding AG ("Day") in the fourth quarter of fiscal 2010, is beginning to result in improved financial performance in this segment.

In our Omniture business, we continued to achieve strong momentum during the first quarter of fiscal 2011 and achieved year-over-year growth of 16%. Driving this success was increased awareness of our Adobe Online Marketing Suite in the marketplace as well as maintaining strong bookings performance. The number of Omniture user transactions in the quarter was 1.38 trillion, an increase of 12% year-over-year versus the comparable period of time a year ago.

Our Print and Publishing business segment decreased year-over-year, primarily due to the timing of Coldfusion product releases.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

In preparing our Condensed Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") and pursuant to the rules and regulations of the SEC, we make assumptions, judgments and estimates that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. On a regular basis, we evaluate our assumptions, judgments and estimates. We also discuss our critical accounting policies and estimates with the Audit Committee of the Board of Directors.

We believe that the assumptions, judgments and estimates involved in the accounting for revenue recognition, stock-based compensation, business combinations, goodwill impairment and income taxes have the greatest potential impact on our Condensed Consolidated Financial Statements. These areas are key components of our results of operations and are based on complex rules which require us to make judgments and estimates, so we consider these to be our critical accounting policies. Historically, our assumptions, judgments and estimates relative to our critical accounting policies have not differed materially from actual results.

There have been no significant changes in our critical accounting policies and estimates during the three months ended March 4, 2011, as compared to the critical accounting policies and estimates disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 3, 2010.

**Recent Accounting Pronouncements Not Yet Effective**

In December 2010, the Financial Accounting Standards Board ("FASB") issued updated accounting guidance related to the calculation of the carrying amount of a reporting unit when performing the first step of a goodwill impairment test. More specifically, this update will require an entity to use an equity premise when performing the first step of a goodwill impairment test and if a reporting unit has a zero or negative carrying amount, the entity must assess and consider qualitative factors and whether it is more likely than not that a goodwill impairment exists. The new accounting guidance is effective for public entities, for impairment tests performed during entities' fiscal years (and interim periods within those years) that begin after December 15, 2010. Early application is not permitted. We will adopt the new disclosures in the first quarter of fiscal 2012, however as we currently do not have any reporting units with a zero or negative carrying amount, we do not expect the adoption of this guidance to have an impact on our

consolidated financial statements.

In December 2010, the FASB issued updated accounting guidance to clarify that pro forma disclosures should be presented as if a business combination occurred at the beginning of the prior annual period for purposes of preparing both the current reporting period and the prior reporting period pro forma financial information. These disclosures should be accompanied by a narrative description about the nature and amount of material, nonrecurring pro forma adjustments. The new accounting guidance is effective for business combinations consummated in periods beginning after December 15, 2010, and should be applied prospectively as of the date of adoption. Early adoption is permitted. We will adopt the new disclosures in the second quarter of fiscal 2011. We do not believe that the adoption of this guidance will have a material impact to our consolidated financial statements.

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## RESULTS OF OPERATIONS

Revenue for the Three Months Ended March 4, 2011 and March 5, 2010 (dollars in millions)

|                             | 2011      | 2010    | % Change |   |
|-----------------------------|-----------|---------|----------|---|
| Product                     | \$842.7   | \$703.9 | 20       | % |
| Percentage of total revenue | 82        | % 82    | %        |   |
| Subscription                | 106.2     | 95.5    | 11       | % |
| Percentage of total revenue | 10        | % 11    | %        |   |
| Services and support        | 78.8      | 59.3    | 33       | % |
| Percentage of total revenue | 8         | % 7     | %        |   |
| Total revenue               | \$1,027.7 | \$858.7 | 20       | % |

As described in Note 17 of our Notes to Condensed Consolidated Financial Statements, we have the following segments: Creative and Interactive Solutions, Digital Media Solutions, Knowledge Worker, Enterprise, Omniture and Print and Publishing.

Our subscription revenue is comprised primarily of fees we charge for our hosted service offerings including our hosted online business optimization services. We recognize subscription revenues ratably over the term of agreements with our customers, beginning on the commencement of the service. Of the \$106.2 million and \$95.5 million in subscription revenue for the three months ended March 4, 2011 and March 5, 2010, respectively, approximately \$92.5 million and \$83.9 million, respectively, is from our Omniture segment with the remaining amounts representing our other business offerings.

Our services and support revenue is comprised of consulting, training and maintenance and support, primarily related to the licensing of our enterprise, developer and platform products and the sale of our hosted online business optimization services. Our support revenue also includes technical support and developer support to partners and developer organizations related to our desktop products. Our maintenance and support offerings which entitle customers to receive product upgrades and enhancements or technical support, depending on the offering, are recognized ratably over the term of the arrangement.

Segment Information (dollars in millions)

|                                    | 2011      | 2010    | % Change |    |
|------------------------------------|-----------|---------|----------|----|
| Creative and Interactive Solutions | \$424.8   | \$332.6 | 28       | %  |
| Percentage of total revenue        | 41        | % 39    | %        |    |
| Digital Media Solutions            | 151.7     | 130.6   | 16       | %  |
| Percentage of total revenue        | 15        | % 15    | %        |    |
| Knowledge Worker                   | 181.8     | 165.9   | 10       | %  |
| Percentage of total revenue        | 18        | % 19    | %        |    |
| Enterprise                         | 104.8     | 78.9    | 33       | %  |
| Percentage of total revenue        | 10        | % 10    | %        |    |
| Omniture                           | 110.9     | 96.0    | 16       | %  |
| Percentage of total revenue        | 11        | % 11    | %        |    |
| Print and Publishing               | 53.7      | 54.7    | (2)      | )% |
| Percentage of total revenue        | 5         | % 6     | %        |    |
| Total revenue                      | \$1,027.7 | \$858.7 | 20       | %  |

Revenue from Creative and Interactive Solutions increased \$92.2 million during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010. This year-over-year increase was driven by strong licensing of CS5. For the three months ended March 4, 2011, our Creative Suite products related revenue increased 38% as compared to the same period in the prior year. The overall number of units licensed for Creative and Interactive Solutions increased when compared to the three months ended March 5, 2010. Unit average selling prices

remained relatively stable during the three months ended March 4, 2011 as compared to the same period in the prior year.

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Revenue from Digital Media Solutions increased \$21.1 million during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010. This increase was due to increased licensing of our CS5 image editing and video authoring products. For the three months ended March 4, 2011, our Photoshop point product revenue increased 14% as compared to the same period in the prior year. The overall number of units licensed for Digital Media Solutions increased when compared to the three months ended March 5, 2010. Unit average selling prices remained relatively stable during the three months ended March 4, 2011 as compared to the same period in the prior year.

Revenue from Knowledge Worker increased \$15.9 million during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010. We attribute this success to increased awareness and adoption of our new Acrobat X product, which shipped in the second half of fiscal 2010. The number of units licensed and unit average selling prices, excluding large enterprise license agreements ("ELA"), increased during the three months ended March 4, 2011 as compared to the same period in the prior year.

Revenue from Enterprise increased \$25.9 million during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010. The increase was primarily due to our addition of products from the acquisition of Day to our Enterprise offering and success in customer adoption as part of our CEM offering.

Revenue from Omniture increased \$14.9 million during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010. This increase was due to adoption of our Online Marketing Suite offering.

Revenue from Print and Publishing decreased \$1.0 million during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010. The decrease was primarily due to the release of Coldfusion 9 at the end of fiscal 2009 for which a comparable release did not occur in the current period.

Geographical Information (dollars in millions)

|                             | 2011      | 2010    | % Change |   |
|-----------------------------|-----------|---------|----------|---|
| Americas                    | \$489.6   | \$408.4 | 20       | % |
| Percentage of total revenue | 48        | % 48    | %        |   |
| EMEA                        | 331.8     | 275.4   | 20       | % |
| Percentage of total revenue | 32        | % 32    | %        |   |
| Asia                        | 206.3     | 174.9   | 18       | % |
| Percentage of total revenue | 20        | % 20    | %        |   |
| Total revenue               | \$1,027.7 | \$858.7 | 20       | % |

Overall revenue for the three months ended March 4, 2011 increased when compared to the three months ended March 5, 2010, primarily due to the launch of CS5 in the second quarter of fiscal 2010 as well as the addition of Day product revenue based on our acquisition of Day in the fourth quarter of fiscal 2010. Increased revenue in our Digital Media Solutions and Knowledge Worker business segments also contributed to the year-over-year growth.

The increase in revenue during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010 in the Americas, EMEA and Asia was attributable to the factors noted above.

As a result of the recent earthquakes and related events that occurred in Japan subsequent to our March 4, 2011 quarter-end, we believe that our operating results in Japan will be adversely impacted in the near term.

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Included in the overall increase in revenue for the three months ended March 4, 2011 as compared to the three months ended March 5, 2010 were impacts associated with foreign currency as shown below:

| (in millions)        | Three Months<br>Increase/(decrease) |
|----------------------|-------------------------------------|
| Revenue impact:      |                                     |
| EMEA:                |                                     |
| Euro                 | \$ (16.0 )                          |
| British Pound        | (0.9 )                              |
| Other currencies     | 0.2                                 |
| Total EMEA           | (16.7 )                             |
| Japanese Yen         | 8.4                                 |
| Other currencies     | 2.4                                 |
| Total revenue impact | (5.9 )                              |
| Hedging impact:      |                                     |
| EMEA                 | —                                   |
| Japanese Yen         | —                                   |
| Total hedging impact | —                                   |
| Total impact         | \$ (5.9 )                           |

During the three months ended March 4, 2011, the U.S. Dollar strengthened against both the Euro and British Pound causing revenue in EMEA measured in U.S. Dollars to decrease compared with the same reporting period last year. Revenue measured in both the Japanese Yen and Australian Dollar was favorably impacted as the U.S. Dollar weakened against these currencies. Our currency hedging programs resulted in no hedging gains as noted in the table above.

**Product Backlog**

The actual amount of product backlog at any particular time may not be a meaningful indicator of future business prospects. Shippable backlog is comprised of unfulfilled orders, excluding those associated with new product releases, those pending credit review and those not shipped due to the application of our global inventory policy. We had no shippable backlog at the end of the first quarter of fiscal 2011. Our shippable backlog at the end of the fourth quarter of fiscal 2010 was approximately 5% of fourth quarter fiscal 2010 revenue.

Cost of Revenue for the Three Months Ended March 4, 2011 and March 5, 2010 (dollars in millions)

|                             | 2011    | 2010   | % Change |   |
|-----------------------------|---------|--------|----------|---|
| Product                     | \$30.7  | \$23.6 | 30       | % |
| Percentage of total revenue | 3       | % 3    | %        |   |
| Subscription                | 47.9    | 45.7   | 5        | % |
| Percentage of total revenue | 5       | % 5    | %        |   |
| Services and support        | 29.0    | 20.1   | 44       | % |
| Percentage of total revenue | 3       | % 2    | %        |   |
| Total cost of revenue       | \$107.6 | \$89.4 | 20       | % |

**Product**

Cost of product revenue includes product packaging, third-party royalties, excess and obsolete inventory, amortization related to localization costs, purchased intangibles and acquired rights to use technology and the costs associated with the manufacturing of our products.

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Cost of product revenue increased due to the following:

|  | % Change<br>2011-2010<br>QTD |   |
|--|------------------------------|---|
| Localization costs related to our product launches | 13                           | % |
| Amortization of purchased intangibles              | 9                            |   |
| Excess and obsolete inventory                      | 5                            |   |
| Cost of sales                                      | 4                            |   |
| Royalty cost                                       | 1                            |   |
| Amortization of acquired rights to use technology  | (1                           | ) |
| Various individually insignificant items           | (1                           | ) |
| Total change                                       | 30                           | % |

Localization costs increased during the three months ended March 4, 2011 as compared to the three months March 5, 2010 primarily due to the launch of Acrobat X products during the fourth quarter of fiscal 2010. Further, localization costs for CS4 products had been fully amortized as of the end of fiscal 2009.

Amortization of purchased intangibles increased during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010, primarily due to amortization expense associated with intangible assets purchased through acquisitions.

Excess and obsolete inventory increased during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010 due to reserve requirements primarily for Acrobat 9.0, Creative Suite and Photoshop point products.

Cost of sales increased primarily due to the associated increase in shrink-wrap shipments of our Creative Suite and Photoshop point products.

#### Subscription

Cost of subscription revenue consists of expenses related to operating our network infrastructure, including depreciation expenses and operating lease payments associated with computer equipment, data center costs, salaries and related expenses of network operations, implementation, account management and technical support personnel, amortization of intangible assets and allocated overhead. We enter into contracts with third-parties for the use of their data center facilities and our data center costs largely consist of the amounts we pay to these third-parties for rack space, power and similar items.

Cost of subscription revenue increased during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010 primarily due to increases in compensation and related benefits driven by additional headcount in addition to increases in data center costs related to higher transaction volumes.

#### Services and Support

Cost of services and support revenue is primarily comprised of employee-related costs and associated costs incurred to provide consulting services, training and product support.

Cost of services and support revenue increased during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010, primarily due to increases in compensation and related benefits driven by additional headcount.



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## Operating Expenses for the Three Months Ended March 4, 2011 and March 5, 2010 (dollars in millions)

|                                       | 2011    | 2010    | % Change |    |
|---------------------------------------|---------|---------|----------|----|
| Research and development              | \$178.4 | \$174.3 | 2        | %  |
| Percentage of total revenue           | 17      | % 20    | %        |    |
| Sales and marketing                   | 328.1   | 297.3   | 10       | %  |
| Percentage of total revenue           | 32      | % 35    | %        |    |
| General and administrative            | 101.0   | 91.1    | 11       | %  |
| Percentage of total revenue           | 10      | % 11    | %        |    |
| Restructuring charges                 | —       | 11.6    | (100)    | )% |
| Percentage of total revenue           | —       | % 1     | %        |    |
| Amortization of purchased intangibles | 10.2    | 18.2    | (44)     | )% |
| Percentage of total revenue           | 1       | % 2     | %        |    |
| Total operating expenses              | \$617.7 | \$592.5 | 4        | %  |

## Research and Development, Sales and Marketing, and General and Administrative Expenses

The increase in research and development, sales and marketing and general and administrative expenses during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010 was primarily driven by higher employee compensation due to additional headcount. For comparative purposes, the change in compensation during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010 in the analysis which follows has been normalized for the impact of the extra week in the first quarter of fiscal 2010.

## Research and Development

Research and development expenses consist primarily of salary and benefit expenses for software developers, contracted development efforts, related facilities costs and expenses associated with computer equipment used in software development.

Research and development expenses increased due to the following:

|  | % Change<br>2011-2010<br>QTD |   |
|--|------------------------------|---|
| Compensation and related benefits associated with headcount growth               | 5                            | % |
| Compensation associated with incentive compensation and stock-based compensation | (1)                          | ) |
| Various individually insignificant items   | (2)                          | ) |
| Total change   | 2                            | % |

We believe that investments in research and development, including the recruiting and hiring of software developers, are critical to remain competitive in the marketplace and are directly related to continued timely development of new and enhanced products. We will continue to focus on long-term opportunities available in our end markets and make significant investments in the development of our application, tool and service offerings.

## Sales and Marketing

Sales and marketing expenses consist primarily of salary and benefit expenses, sales commissions, travel expenses and related facilities costs for our sales, marketing, order management and global supply chain management personnel. Sales and marketing expenses also include the costs of programs aimed at increasing revenue, such as advertising, trade shows, public relations and other market development programs.

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Sales and marketing expenses increased due to the following:

|  | % Change<br>2011-2010<br>QTD |   |
|--|------------------------------|---|
| Marketing spending related to product launches and overall marketing efforts to further increase revenue | 6                            | % |
| Compensation and related benefits associated with headcount growth                                       | 5                            |   |
| Compensation associated with incentive compensation and stock-based compensation                         | —                            |   |
| Various individually insignificant items   | (1                           | ) |
| Total change   | 10                           | % |

#### General and Administrative

General and administrative expenses consist primarily of compensation and benefit expenses, travel expenses and related facilities costs for our finance, facilities, human resources, legal, information services and executive personnel. General and administrative expenses also include outside legal and accounting fees, provision for bad debts, expenses associated with computer equipment and software used in the administration of the business, charitable contributions and various forms of insurance.

General and administrative expenses increased due to the following:

|  | % Change<br>2011-2010<br>QTD |   |
|--|------------------------------|---|
| Professional and consulting fees   | 6                            | % |
| Compensation and related benefits associated with headcount growth               | 4                            |   |
| Compensation associated with incentive compensation and stock-based compensation | 3                            |   |
| Various individually insignificant items   | (2                           | ) |
| Total change   | 11                           | % |

#### Restructuring Charges

##### Fiscal 2009 Restructuring Plan

In the fourth quarter of fiscal 2009, in order to appropriately align our costs in connection with our fiscal 2010 operating plan, we initiated a restructuring plan consisting of reductions in workforce and the consolidation of facilities. The restructuring activities related to this program affect only those employees and facilities that were associated with Adobe prior to the acquisition of Omniture on October 23, 2009.

In the first quarter of fiscal 2010, we continued to implement restructuring activities under this program. We vacated approximately 8,000 square feet of sales facilities in Australia, Canada, Denmark and the U.S. We accrued \$0.4 million for the fair value of our future contractual obligations under those operating leases and we recorded charges of \$11.9 million for termination benefits. We also recorded net adjustments of approximately \$1.1 million to reflect net decreases in previously recorded estimates for termination benefits and facilities-related liabilities in addition to minor adjustments for fluctuations related to foreign currency translation.

In the first quarter of fiscal 2011, we recorded minor adjustments for changes in previously recorded estimates and for fluctuations related to foreign currency translation.

##### Fiscal 2008 Restructuring Plan

In the fourth quarter of fiscal 2008, we initiated a restructuring program consisting of reductions in workforce and the consolidation of facilities, in order to reduce our operating costs and focus our resources on key strategic priorities. In connection with the restructuring plan, we recognized costs related to termination benefits for employee positions that were eliminated and for the closure of duplicative facilities. In the first quarter of fiscal 2010 and 2011, we recorded minor adjustments for changes in previously recorded estimates and for fluctuations related to foreign currency

translation.

See Note 11 of our Notes to Condensed Consolidated Financial Statements for further information regarding our restructuring plans.

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## Amortization of Purchased Intangibles

Amortization expense decreased 44% during the three months ended March 4, 2011 as compared to the three months ended March 5, 2010 primarily due to a decrease in amortization expense associated with intangible assets purchased through our acquisition of Macromedia that were fully amortized at the end of fiscal 2010.

Non-Operating Income (Expense), Net for the Three Months Ended March 4, 2011 and March 5, 2010 (dollars in millions)

|   | 2011    |    | 2010    |    | % Change |    |
|---|---------|----|---------|----|----------|----|
| Interest and other income (expense), net  | \$(0.8  | )  | \$0.6   |    | (233     | )% |
| Percentage of total revenue               | *       |    | *       |    |          |    |
| Interest expense                          | (17.0   | )  | (7.7    | )  | 121      | %  |
| Percentage of total revenue               | (2      | )% | (1      | )% |          |    |
| Investment gains (losses), net            | 1.6     |    | (3.5    | )  | (146     | )% |
| Percentage of total revenue               | *       |    | *       |    |          |    |
| Total non-operating income (expense), net | \$(16.2 | )  | \$(10.6 | )  | 53       | %  |

(\*) Percentage is less than 1%.

## Interest and Other Income (Expense), Net

Interest and other income (expense), net consists primarily of interest earned on cash, cash equivalents and short-term fixed income investments. Interest and other income (expense), net also includes foreign exchange gains and losses, including those from hedging revenue transactions primarily denominated in Euro and Yen currencies, and gains and losses on fixed income investments.

Interest and other income (expense), net for the three months ended March 4, 2011 as compared to the three months ended March 5, 2010 increased in expense primarily due to increased foreign exchange losses partially offset by increased interest income due to higher investment balances and higher average interest rates on our investments.

## Interest Expense

In February 2010, we issued \$600.0 million of 3.25% senior notes due February 1, 2015 (the "2015 Notes") and \$900.0 million of 4.75% senior notes due February 1, 2020 (the "2020 Notes" and, together with the 2015 Notes, the "Notes"). On February 1, 2010, we repaid our \$1.0 billion outstanding credit facility with a portion of the proceeds from our Notes. The increase in interest expense is primarily due to interest associated with higher borrowings resulting from the issuance of the Notes as well as an increase in our average borrowing rate due to the Notes.

## Investment Gains (Losses), Net

Investment gains (losses), net consists principally of realized gains or losses from the sale of marketable equity investments, other-than-temporary declines in the value of marketable and non-marketable equity securities and unrealized holding gains and losses associated with our deferred compensation plan assets (classified as trading securities). Our net investment gains for the three months ended March 4, 2011 were due to gains from our direct and equity investments. Our net investment losses during the three months ended March 5, 2010 were due to unrealized losses related to our Adobe Ventures investments that did not recur during the three months ended March 4, 2011 due to the liquidation of holdings in our Adobe Ventures portfolio of companies at the end of fiscal 2010.

Provision for Income Taxes for the Three Months Ended March 4, 2011 and March 5, 2010 (dollars in millions)

|                             | 2011   |  | 2010   |  | % Change |   |
|-----------------------------|--------|--|--------|--|----------|---|
| Provision                   | \$51.5 |  | \$39.1 |  | 32       | % |
| Percentage of total revenue | 5      |  | % 5    |  | %        |   |
| Effective tax rate          | 18.0   |  | % 23.5 |  | %        |   |

Our effective tax rate decreased by approximately six percentage points for the three months ended March 4, 2011. A nine percentage point decrease was primarily due to the reinstatement of the federal research and development tax credit in December 2010 and stronger forecasted international profits for fiscal 2011. The reinstatement of the credit was retroactive to January 1, 2010. A \$15.2 million tax benefit for the credit relating to fiscal 2010 was reflected in its

entirety in the first quarter of fiscal 2011.

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This decrease was offset by a three percentage point increase for a one-time charge that was related to our acquisition of Demdex. The charge was the tax cost of inter-company transactions necessary to license certain Demdex assets to Adobe's trading companies so that Demdex's services can be offered to our customers from Adobe companies.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. In addition to providing for U.S. income taxes on earnings from the U.S., we provide for U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the U.S. While we do not anticipate changing our intention regarding permanently reinvested earnings, if certain foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings. Currently, there are a significant amount of foreign earnings upon which U.S. income taxes have not been provided.

**Accounting for Uncertainty in Income Taxes**

The gross liability for unrecognized tax benefits at March 4, 2011 was \$163.5 million, exclusive of interest and penalties. If the total unrecognized tax benefits at March 4, 2011 were recognized in the future, \$147.3 million of unrecognized tax benefits would decrease the effective tax rate, which is net of an estimated \$16.2 million federal benefit related to deducting certain payments on future state tax returns.

As of March 4, 2011, the combined amount of accrued interest and penalties related to tax positions taken on our tax returns was approximately \$15.2 million. This amount is included in non-current income taxes payable.

The timing of the resolution of income tax examinations is highly uncertain as are the amounts and timing of tax payments that are part of any audit settlement process. These events could cause large fluctuations in the balance sheet classification of current and non-current assets and liabilities. We believe that within the next 12 months, it is reasonably possible that either certain audits will conclude or statutes of limitations on certain income tax examination periods will expire, or both. Given the uncertainties described above, we can only determine a range of estimated potential decreases in underlying unrecognized tax benefits ranging from \$0 to approximately \$5 million.

**LIQUIDITY AND CAPITAL RESOURCES**

This data should be read in conjunction with our Condensed Consolidated Statements of Cash Flows.

| (in millions)             | March 4, 2011 | December 3, 2010 |
|---------------------------|---------------|------------------|
| Cash and cash equivalents | \$900.2       | \$749.9          |
| Short-term investments    | \$1,736.7     | \$1,718.1        |
| Working capital           | \$2,365.3     | \$2,148.0        |
| Stockholders' equity      | \$5,425.4     | \$5,192.4        |

A summary of our cash flows is as follows:

| (in millions)  | Three Months Ended |         |
|--|--------------------|---------|
|  | 2011               | 2010    |
| Net cash provided by operating activities                              | \$332.1            | \$259.9 |
| Net cash used for investing activities                                 | (95.1)             | (208.7) |
| Net cash (used for) provided by financing activities                   | (86.5)             | 540.1   |
| Effect of foreign currency exchange rates on cash and cash equivalents | (0.2)              | (1.3)   |
| Net increase in cash and cash equivalents                              | \$150.3            | \$590.0 |

Our primary source of cash is receipts from revenue. The primary uses of cash are payroll related expenses; general operating expenses including marketing, travel and office rent; and cost of product revenue. Other sources of cash are proceeds from the exercise of employee options and participation in the employee stock purchase plan ("ESPP").

Another use of cash is our stock repurchase program, which is described below.

**Cash Flows from Operating Activities**

Net cash provided by operating activities of \$332.1 million for the three months ended March 4, 2011 was primarily comprised of net income plus the net effect of non-cash items. The primary working capital sources of cash were net income

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coupled with decreases in trade receivables and increases in deferred revenue. Trade receivables decreased primarily from product that was shipped in the second half of the fourth quarter of fiscal 2010 and collected during the first quarter of 2011. Increases in deferred revenue related primarily to billing of annual maintenance and support renewals in the first months of the fiscal year, combined with increased activity for Omniture hosted services.

The primary working capital uses of cash were decreases in accrued expenses primarily related to the payment of fiscal 2010 bonuses in the first quarter of fiscal 2011. During the three months ended March 4, 2011, we also made our second semi-annual interest payment associated with our Notes totaling \$31.1 million.

Cash Flows from Investing Activities

Net cash used for investing activities of \$95.1 million for the three months ended March 4, 2011 was primarily due to purchases of short-term investments, offset in part by maturities and sales of short-term investments. Other uses of cash during the three months ended March 4, 2011 represented the acquisition of Demdex as well as the purchases of property and equipment and long-term investments and other assets.

Cash Flows from Financing Activities

Net cash used for financing activities of \$86.5 million for the three months ended March 4, 2011 was primarily due to treasury stock repurchases offset in part by proceeds from our treasury stock issuances. See the section titled "Stock Repurchase Program" discussed below.

We expect to continue our investing activities, including short-term and long-term investments, venture capital, facilities expansion and purchases of computer systems for research and development, sales and marketing, product support and administrative staff. Furthermore, cash reserves may be used to repurchase stock under our stock repurchase program and to strategically acquire companies, products or technologies that are complementary to our business.

Restructuring

During the past several years, we have initiated various restructuring plans. Currently, we have the following four active restructuring plans, two of which were the result of large acquisitions:

• Fiscal 2009 Restructuring Plan

• Fiscal 2008 Restructuring Plan

• Omniture Restructuring Plan

• Macromedia Restructuring Plan

As of March 4, 2011, we have accrued total restructuring charges of approximately \$14.1 million of which approximately \$2.0 million relates to ongoing termination benefits and contract terminations and are expected to be paid during the second quarter of fiscal 2011. The remaining \$12.1 million relates to the cost of closing redundant facilities and are expected to be paid under contract through fiscal 2021 of which over 75% will be paid through 2015. During the three months ended March 4, 2011, we made payments related to the above restructuring plans totaling approximately \$2.6 million which consisted of approximately \$2.1 million related to the cost of closing redundant facilities and approximately \$0.5 million related to termination benefits and contract terminations.

We believe that our existing cash and cash equivalents, short-term investments and cash generated from operations will be sufficient to meet the cash outlays for the restructuring actions described above.

See Note 11 of our Notes to Condensed Consolidated Financial Statements for more detailed information regarding our restructuring plans.

Other Liquidity and Capital Resources Considerations

Our existing cash, cash equivalents and investment balances may fluctuate during the remainder of fiscal 2011 due to changes in our planned cash outlay, including changes in incremental costs such as direct and integration costs related to our acquisitions. A majority of our cash and investments are held by our foreign subsidiaries. Our intent is to permanently reinvest a significant portion of our earnings from foreign operations, and current plans do not anticipate that we will need funds generated from foreign operations to fund our domestic operations. In the event funds from foreign operations are needed to fund operations in the United States and if U.S. tax has not already been previously



provided, we would be required to accrue and pay additional U.S. taxes in order to repatriate these funds.

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Cash from operations could also be affected by various risks and uncertainties, including, but not limited to the risks detailed in Part II, Item 1A titled "Risk Factors". However, based on our current business plan and revenue prospects, we believe that our existing balances, our anticipated cash flows from operations and our available credit facility will be sufficient to meet our working capital and operating resource expenditure requirements for the next twelve months.

As of March 4, 2011, the amount outstanding under the Notes was \$1.5 billion. On February 1, 2010, we used \$1.0 billion of the proceeds from this offering to pay the outstanding balance on our credit facility. The remainder of the proceeds from the Notes are available for general corporate purposes. There is no outstanding balance under our credit facility and the entire \$1.0 billion credit line under this facility remains available for borrowing.

We use professional investment management firms to manage a large portion of our invested cash. External investment firms managed, on average, 63% of our consolidated invested balances during the first quarter of fiscal 2011. The fixed income portfolio is primarily invested in U.S. Treasury securities, U.S. agency securities, municipal securities, corporate bonds and foreign government securities.

**Stock Repurchase Program**

During the third quarter of fiscal 2010, our Board of Directors approved an amendment to our stock repurchase program authorized in April 2007 from a non-expiring share-based authority to a time-constrained dollar-based authority. As part of this amendment, the Board of Directors granted authority to repurchase up to \$1.6 billion in common stock through the end of fiscal 2012.

During the three months ended March 4, 2011, we entered into a structured stock repurchase agreement with a large financial institution, whereupon we provided them with a prepayment of \$125.0 million. We did not enter into any new structured repurchase agreements during the three months ended March 5, 2010. We enter into these agreements in order to take advantage of repurchasing shares at a guaranteed discount to the Volume Weighted Average Price ("VWAP") of our common stock over a specified period of time. We only enter into such transactions when the discount that we receive is higher than the foregone return on our cash prepayments to the financial institutions. There were no explicit commissions or fees on these structured repurchases. Under the terms of the agreements, there is no requirement for the financial institutions to return any portion of the prepayment to us.

The financial institutions agree to deliver shares to us at monthly intervals during the contract term. The parameters used to calculate the number of shares deliverable are: the total notional amount of the contract, the number of trading days in the contract, the number of trading days in the interval and the average VWAP of our stock during the interval less the agreed upon discount. During the three months ended March 4, 2011, we repurchased approximately 2.5 million shares at an average price of \$32.84 through structured repurchase agreements entered into during the three months ended March 4, 2011. During the three months ended March 5, 2010, we repurchased approximately 1.7 million shares at an average price of \$36.21 through structured repurchase agreements entered into during fiscal 2009. Subsequent to March 4, 2011, as part of our \$1.6 billion stock repurchase program, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of \$420.0 million. This amount will be classified as treasury stock on our Condensed Consolidated Balance Sheets. Upon completion of the \$420.0 million stock repurchase agreement, \$455.0 million remains under our time-constrained dollar-based authority. See Note 12 and Note 18 of our Notes to Condensed Consolidated Financial Statements for further discussion of our stock repurchase program.

Refer to Part II, Item 2 in this report for share repurchases during the quarter ended March 4, 2011.

**Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**

We presented our contractual obligations in our Annual Report on Form 10-K for the fiscal year ended December 3, 2010. Our principal commitments as of March 4, 2011 consist of obligations under operating leases, capital leases, royalty agreements and various service agreements. There have been no significant changes in those obligations during the three months ended March 4, 2011. See Notes 14 and 15 of our Notes to Condensed Consolidated Financial Statements for more detailed information.

**Notes**

Interest on our Notes is payable semi-annually, in arrears on February 1 and August 1, commencing on August 1, 2010. At March 4, 2011, our maximum commitment for interest payments under the Notes was \$462.8 million.

Financial Covenants

Our credit facility contains a financial covenant requiring us not to exceed a certain maximum leverage ratio. Our leases for the East and West Towers and the Almaden Tower are both subject to standard covenants including certain financial ratios as

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defined in the lease agreements that are reported to the lessors quarterly. As of March 4, 2011, we were in compliance with all of our covenants. Our Notes do not contain any financial covenants. We believe these covenants will not impact our credit or cash in the coming fiscal year or restrict our ability to execute our business plan.

### Royalties

We have certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense is generally based on a dollar amount per unit shipped or a percentage of the underlying revenue.

### Guarantees

The lease agreements for our corporate headquarters provide for residual value guarantees. The fair value of a residual value guarantee in lease agreements entered into after December 31, 2002, must be recognized as a liability on our Condensed Consolidated Balance Sheets. As such, we recognized \$5.2 million and \$3.0 million in liabilities, related to the extended East and West Towers and Almaden Tower leases, respectively. These liabilities are recorded in other long-term liabilities with the offsetting entry recorded as prepaid rent in other assets. The balance will be amortized to our Condensed Consolidated Statements of Income over the life of the leases. As of March 4, 2011 and December 3, 2010, the unamortized portion of the fair value of the residual value guarantees, for both leases, remaining in other long-term liabilities and prepaid rent was \$0.6 million and \$0.7 million, respectively.

### Indemnifications

In the normal course of business, we provide indemnifications of varying scope to customers against claims of intellectual property infringement made by third parties arising from the use of our products. Historically, costs related to these indemnification provisions have not been significant and we are unable to estimate the maximum potential impact of these indemnification provisions on our future results of operations.

To the extent permitted under Delaware law, we have agreements whereby we indemnify our directors and officers for certain events or occurrences while the director or officer is, or was serving, at our request in such capacity. The indemnification period covers all pertinent events and occurrences during the director's or officer's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have director and officer insurance coverage that limits our exposure and enables us to recover a portion of any future amounts paid. We believe the estimated fair value of these indemnification agreements in excess of applicable insurance coverage is minimal.

During fiscal 2010, our limited partnership interest in Adobe Ventures was dissolved and all remaining assets were distributed to the partners. As part of this limited partnership interest, we provided a general indemnification to Granite Ventures, an independent venture capital firm and sole general partner of Adobe Ventures, for certain events or occurrences while Granite Ventures was serving at our request in such capacity provided that Granite Ventures acted in good faith on behalf of the partnership.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We believe that there have been no significant changes in our market risk exposures for the three months ended March 4, 2011 as compared with those discussed in our Annual Report on Form 10-K for the fiscal year ended December 3, 2010.

## ITEM 4. CONTROLS AND PROCEDURES

Based on their evaluation as of March 4, 2011, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) were effective at the reasonable assurance level to ensure that the information required to be disclosed by us in this quarterly report on Form 10-Q was (i) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and regulations and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

There were no changes in our internal control over financial reporting during the quarter ended March 4, 2011 that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting. Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of

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controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Adobe have been detected.

PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note 14 “Commitments and Contingencies” of our Notes to Condensed Consolidated Financial Statements regarding our legal proceedings.

ITEM 1A. RISK FACTORS

As previously discussed, our actual results could differ materially from our forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed below. These and many other factors described in this report could adversely affect our operations, performance and financial condition.

If we cannot continue to develop, market and distribute new products and services or upgrades or enhancements to existing products and services that meet customer requirements, our operating results could suffer.

The process of developing new high technology products and services and enhancing existing products and services is complex, costly and uncertain, and any failure by us to anticipate customers' changing needs and emerging technological trends accurately could significantly harm our market share and results of operations. We must make long-term investments, develop or obtain appropriate intellectual property and commit significant resources before knowing whether our predictions will accurately reflect customer demand for our products and services. Our inability to extend our core technologies into new applications and new platforms, including the mobile and non-pc devices market, and to anticipate or respond to technological changes could affect continued market acceptance of our products and services and our ability to develop new products and services. Additionally, any delay in the development, production, marketing or distribution of a new product or service or upgrade or enhancement to an existing product or service could cause a decline in our revenue, earnings or stock price and could harm our competitive position. We maintain strategic relationships with third parties with respect to the distribution of certain of our technologies. If we are unsuccessful in establishing or maintaining our strategic relationships with these third parties, our ability to compete in the marketplace or to grow our revenues would be impaired and our operating results would suffer.

We offer our PC application-based products primarily on Windows and Macintosh platforms. We generally offer our server-based products on the Linux platform as well as the Windows and UNIX platforms. To the extent that there is a slowdown of customer purchases of personal computers on either the Windows or Macintosh platform or in general, to the extent that we have difficulty transitioning product or version releases to new Windows and Macintosh operating systems, or to the extent that significant demand arises for our products or competitive products on other platforms before we choose and are able to offer our products on these platforms our business could be harmed. To the extent new releases of operating systems or other third-party products, platforms or devices make it more difficult for our products to perform, and our customers are persuaded to use alternative technologies, our business could be harmed.

Introduction of new products, services and business models by existing and new competitors could harm our competitive position and results of operations.

The markets for our products and services are characterized by intense competition, evolving industry standards and business and distribution models, disruptive software and hardware technology developments, frequent new product and service introductions, short product and service life cycles, price cutting, with resulting downward pressure on gross margins, and price sensitivity on the part of consumers. Our future success will depend on our ability to enhance our existing products and services, introduce new products and services on a timely and cost-effective basis, meet changing customer needs, extend our core technology into new applications, and anticipate and respond to emerging

standards, business models, software delivery methods and other technological changes. If any competing products, services, or operating systems achieve widespread acceptance, our operating results could suffer. In addition, consolidation has occurred among some of the competitors in our markets. Any further consolidations among our competitors may result in stronger competitors and may therefore harm our results of operations. For additional information regarding our competition and the risks arising out of the competitive environment in which we operate, see the section entitled "Competition" contained in Item 1 of our Annual Report on Form 10-K for fiscal 2010. If we fail to successfully manage transitions to new business models and markets, our results of operations could be negatively impacted.

We plan to release numerous new product and service offerings and employ new software delivery methods in connection with our diversification into new business models and markets. It is uncertain whether these strategies will prove successful or that we will be able to develop the infrastructure and business models as quickly as our competitors. Market acceptance of these

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new product and service offerings will be dependent on our ability to include functionality and usability in such releases that address certain customer requirements with which we have limited prior experience and operating history. Some of these new product and service offerings could subject us to increased risk of legal liability related to the provision of services as well as cause us to incur significant technical, legal or other costs. For example, with our introduction of on-demand services and subscription-based licensing models, we are entering a market that is at an early stage of development. Market acceptance of such services is affected by a variety of factors, including security, reliability, performance, customer concerns with entrusting a third party to store and manage their data, public concerns regarding privacy and the enactment of laws or regulations that restrict our ability to provide such services to customers in the U.S. or internationally. As our business continues to transition to new business models that may be more highly regulated for privacy and data security, and to countries outside the U.S. that have more stringent data protection laws, our liability exposure, compliance requirements and costs may increase. In addition, recently there has been increasing sensitivity of consumers to the use of personal information and unauthorized data disclosure, which has resulted in regulatory scrutiny in the U.S. and other countries. As a result, laws and industry practices in the areas of privacy and online advertising are likely to change and technological solutions to comply with these changes may be required or necessary, either of which could result in significant limitations on or changes to the ways in which we and our customers can collect, process, use, store or transmit the information of customers or employees, communicate with customers, and deliver products and services. Further, any perception of our practices or products as an invasion of privacy, whether or not consistent with current regulations and industry practices, may subject us to public criticism and reputational harm or claims by regulators, industry groups or other third parties, all of which could harm our business.

Additionally, customer requirements for open standards or open source products could impact adoption or use of some of our products or services. To the extent we incorrectly predict customer requirements for such products or services or if there is a delay in market acceptance of such products or services, our business could be harmed.

From time to time we open source certain of our technology initiatives, provide broader open access to our technology, license certain of our technology on a royalty-free basis, and release selected technology for industry standardization. These changes may have negative revenue implications and make it easier for our competitors to produce products or services similar to ours. If we are unable to respond to these competitive threats, our business could be harmed.

We are also devoting significant resources to the development of technologies and service offerings in markets where we have a limited operating history, including the enterprise, government and mobile and non-pc device markets. In the enterprise market, we intend to increase our focus on vertical markets such as education, financial services, and manufacturing. These new offerings and markets require a considerable investment of technical, financial and sales resources, and a scalable organization. Many of our competitors may have advantages over us due to their larger presence, larger developer network, deeper experience in the enterprise, government and mobile and non-pc device markets, and greater sales, consulting and marketing resources. In the mobile and non-pc device markets, our intent is to partner with device makers, chipset and OS vendors, manufacturers and telecommunications carriers to embed our technology on their platforms, and in the enterprise and government market our intent is to form strategic alliances with leading enterprise and government solutions and service providers to provide additional resources to further enable penetration of such markets. If we are unable to successfully enter into strategic alliances with device makers, manufacturers, telecommunication carriers and leading enterprise and government solutions and service providers, or if they are not as productive as we anticipate, our market penetration may not proceed as rapidly as we anticipate and our results of operations could be negatively impacted.

Revenue from our product and service offerings may be difficult to predict.

As previously discussed, we are devoting significant resources to the development of product and service offerings as well as new distribution models where we have a limited operating history. For example, we intend to implement a subscription licensing model to augment our traditional perpetual licensing model. This makes it difficult to predict revenue and license revenue may decline more quickly than anticipated. Additionally, we have a limited history of licensing products and offering services in certain markets such as the government and enterprise market and may experience a number of factors that will make our revenue less predictable, including longer than expected sales and



implementation cycles, decisions to open source certain of our technology initiatives, potential deferral of revenue due to multiple-element revenue arrangements and alternate licensing arrangements. If any of our assumptions about revenue from our new businesses prove incorrect, our actual results may vary materially from those anticipated, estimated or projected.

For instance, the SaaS business model we utilize in our Omniture business unit typically involves selling services on a subscription basis pursuant to service agreements that are generally one to three years in length. Although many of our service agreements contain automatic renewal terms, our customers have no obligation to renew their subscriptions for our services after the expiration of their initial subscription period upon providing timely notice of non-renewal and we cannot provide assurance that these subscriptions will be renewed at the same or higher level of service, if at all. Moreover, under some circumstances, some of our customers have the right to cancel their service agreements prior to the expiration of the terms of their agreements. We cannot be assured that we will be able to accurately predict future customer renewal rates. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our services, the prices

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of our services, the prices of services offered by our competitors, mergers and acquisitions affecting our customer base, reductions in our customers' spending levels, or declines in consumer Internet activity as a result of economic downturns or uncertainty in financial markets. If our customers do not renew their subscriptions for our services or if they renew on less favorable terms to us, our revenues may decline.

Uncertainty about future economic conditions and other adverse changes in general political conditions in any of the major countries in which we do business could adversely affect our operating results.

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic and political conditions. Uncertainty about future economic and political conditions, including the impact of the earthquakes and related events in Japan on us, our customers, suppliers and partners, makes it difficult for us to forecast operating results and to make decisions about future investments. If economic growth in the U.S. and other countries, including Japan, slows or does not improve, many customers may delay or reduce technology purchases, advertising spending or marketing spending. This could result in reductions in sales of our products and services, longer sales cycles, slower adoption of new technologies and increased price competition. Financial institutions may continue to consolidate or cease to do business which could result in a tightening in the credit markets, a low level of liquidity in many financial markets, and increased volatility in fixed income, credit, currency and equity markets. There could be a number of effects from a credit crisis on our business, which could include impaired credit availability and financial stability of our customers, including our distribution partners and channels. A disruption in the financial markets may also have an effect on our derivative counterparties and could also impair our banking partners on which we rely for operating cash management. Any of these events would likely harm our business, results of operations and financial condition.

Political instability in any of the major countries we do business in would also likely harm our business, results of operations and financial condition.

We may not realize the anticipated benefits of past or future acquisitions, and integration of these acquisitions may disrupt our business and management.

We have in the past and may in the future acquire additional companies, products or technologies. Recently, we completed the acquisition of Omniture in October 2009 and completed the acquisition of Day in October 2010. We may not realize the anticipated benefits of an acquisition and each acquisition has numerous risks. These risks include:

- difficulty in integrating the operations and personnel of the acquired company;
- difficulty in effectively integrating the acquired technologies, products or services with our current technologies, products or services;
- difficulty in maintaining controls, procedures and policies during the transition and integration;
- entry into markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions;
- disruption of our ongoing business and distraction of our management and employees from other opportunities and challenges;
- difficulty integrating the acquired company's accounting, management information, human resources and other administrative systems;
- inability to retain key technical and managerial personnel of the acquired business;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- inability to achieve the financial and strategic goals for the acquired and combined businesses;
- inability to take advantage of anticipated tax benefits as a result of unforeseen difficulties in our integration activities;
- incurring acquisition-related costs or amortization costs for acquired intangible assets that could impact our operating results;
- potential additional exposure to fluctuations in currency exchange rates;
- potential impairment of our relationships with employees, customers, partners, distributors or third-party providers of our technologies, products or services;
- potential failure of the due diligence processes to identify significant problems, liabilities or other shortcomings or challenges of an acquired company or technology, including but not limited to, issues with the acquired company's

intellectual property, product quality or product architecture, data back-up and security, privacy practices, revenue recognition or other accounting practices, employee, customer or partner issues or legal and financial contingencies;

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unexpected changes in, or impositions of, legislative or regulatory requirements impacting the acquired business; exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, including but not limited to, claims from terminated employees, customers, former stockholders or other third parties;

incurring significant exit charges if products or services acquired in business combinations are unsuccessful;

potential inability to assert that internal controls over financial reporting are effective;

potential inability to obtain, or obtain in a timely manner, approvals from governmental authorities, which could delay or prevent such acquisitions;

potential delay in customer and distributor purchasing decisions due to uncertainty about the direction of our product and service offerings; and

potential incompatibility of business cultures.

Mergers and acquisitions of high technology companies are inherently risky, and ultimately, if we do not complete an announced acquisition transaction or integrate an acquired business successfully and in a timely manner, we may not realize the benefits of the acquisition to the extent anticipated.

We may incur substantial costs enforcing or acquiring intellectual property rights and defending against third-party claims as a result of litigation or other proceedings.

In connection with the enforcement of our own intellectual property rights, the acquisition of third-party intellectual property rights, or disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently and may in the future be subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation are typically very costly and can be disruptive to our business operations by diverting the attention and energies of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. Third-party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products or offering certain of our services, subject us to injunctions restricting our sale of products or services, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various license arrangements and service agreements. In addition, we may incur significant costs in acquiring the necessary third-party intellectual property rights for use in our products. Any of these could seriously harm our business.

We may not be able to protect our intellectual property rights, including our source code, from third-party infringers, or unauthorized copying, use or disclosure.

Although we defend our intellectual property rights and combat unlicensed copying and use of software and intellectual property rights through a variety of techniques, preventing unauthorized use or infringement of our rights is inherently difficult. We actively pursue software piracy as part of our enforcement of our intellectual property rights, but we nonetheless lose significant revenue due to illegal use of our software. If piracy activities increase, it may further harm our business.

Additionally, we take significant measures to protect the secrecy of our confidential information and trade secrets, including our source code. If unauthorized disclosure of our source code occurs through security breach or attack, or otherwise, we could potentially lose future trade secret protection for that source code. The loss of future trade secret protection could make it easier for third-parties to compete with our products by copying functionality, which could adversely affect our revenue and operating margins. We also seek to protect our confidential information and trade secrets through the use of non-disclosure agreements with our customers, contractors, vendors, and partners. However there is a risk that our confidential information and trade secrets may be disclosed or published without our authorization, and in these situations it may be difficult and/or costly for us to enforce our rights.

Security vulnerabilities in our products and systems could lead to reduced revenues or to liability claims.

Maintaining the security of computers and computer networks is a critical issue for us and our customers. Hackers may develop and deploy viruses, worms, and other malicious software programs that are designed to attack our products and systems, including our internal network. Although this is an industry-wide problem that affects computers and products across all platforms, it affects our products in particular because hackers tend to focus their

efforts on the most popular operating systems and programs and we expect them to continue to do so. Critical vulnerabilities have been identified in certain of our products. These vulnerabilities could cause the application to crash and could potentially allow an attacker to take control of the affected system.

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We devote significant resources to address security vulnerabilities through engineering more secure products, enhancing security and reliability features in our products and systems, code hardening, deploying security updates to address security vulnerabilities and improving our incident response time. The cost of these steps could reduce our operating margins. Despite these efforts, actual or perceived security vulnerabilities in our products and systems may lead to claims against us and harm our reputation, and could lead some customers to seek to return products, to stop using certain services, to reduce or delay future purchases of products or services, or to use competing products or services. Customers may also increase their expenditures on protecting their existing computer systems from attack, which could delay adoption of new technologies. Any of these actions by customers could adversely affect our revenue.

Some of our businesses rely on us or third-party service providers to host and deliver services, and any interruptions or delays in our service or service from these third parties, security or privacy breaches, or failures in data collection could expose us to liability and harm our business and reputation.

Some of our businesses and services, including our online store at adobe.com and Omniture business unit, rely on services hosted and controlled directly by us or by third parties. Because we hold large amounts of customer data and host certain of such data in third-party facilities, a security incident may compromise the integrity or availability of customer data, or customer data may be exposed to unauthorized access. Unauthorized access to customer data may be obtained through break-ins, breach of our secure network by an unauthorized party, employee theft or misuse, or other misconduct. It is also possible that unauthorized access to customer data may be obtained through inadequate use of security controls by customers. While strong password controls, IP restriction and account controls are provided and supported, their use is controlled by the customer. As such, this could allow accounts to be created with weak passwords, which could result in allowing an attacker to gain access to customer data. Additionally, failure by customers to remove accounts of their own employees, or granting of accounts by the customer in an uncontrolled manner, may allow for access by former or unauthorized customer employees. If there were ever an inadvertent disclosure of personal information, or if a third party were to gain unauthorized access to the personal information we possess on behalf of our customers, our operations could be disrupted, our reputation could be harmed and we could be subject to claims or other liabilities. In addition, such perceived or actual unauthorized disclosure of the information we collect or breach of our security could result in the loss of customers and harm our business.

Because of the large amount of data that we collect and manage on behalf of our customers, it is possible that hardware or software failures or errors in our systems could result in data loss or corruption or cause the information that we collect to be incomplete or contain inaccuracies that our customers regard as significant. Furthermore, our ability to collect and report data may be delayed or interrupted by a number of factors, including access to the Internet, the failure of our network or software systems, security breaches or significant variability in visitor traffic on customer Websites. In addition, computer viruses may harm our systems causing us to lose data, and the transmission of computer viruses could expose us to litigation. We may also find, on occasion, that we cannot deliver data and reports to our customers in near real time because of a number of factors, including significant spikes in consumer activity on their Websites or failures of our network or software. We may be liable to our customers for damages they may incur resulting from these events, such as loss of business, loss of future revenues, breach of contract or for the loss of goodwill to their business. In addition to potential liability, if we supply inaccurate information or experience interruptions in our ability to capture, store and supply information in near real time or at all, our reputation could be harmed and we could lose customers.

On behalf of certain of our customers using our services, we collect and store information derived from the activities of Website visitors, which may include anonymous and/or personal information. This enables us to provide such customers with reports on aggregated anonymous or personal information from and about the visitors to their Websites in the manner specifically directed by each such individual customer. Federal, state and foreign government bodies and agencies have adopted or are considering adopting laws regarding the collection, use and disclosure of this information. Therefore, our compliance with privacy laws and regulations and our reputation among the public body of Website visitors depend on such customers' adherence to privacy laws and regulations and their use of our services in ways consistent with such visitors' expectations. We also rely on representations made to us by customers that their own use of our services and the information we provide to them via our services do not violate any applicable privacy

laws, rules and regulations or their own privacy policies. We ask customers to represent to us that they provide their Website visitors the opportunity to “opt-out” of the information collection associated with our services, as applicable. We do not formally audit such customers to confirm compliance with these representations. If these representations are false or if such customers do not otherwise comply with applicable privacy laws, we could face potentially adverse publicity and possible legal or other regulatory action.

Failure to manage our sales and distribution channels and third-party customer service and technical support providers effectively could result in a loss of revenue and harm to our business.

A significant amount of our revenue for application products is from one distributor, Ingram Micro, Inc., which represented 14% of our net revenue for the first quarter of fiscal 2011. We have multiple non-exclusive, independently negotiated distribution agreements with Ingram Micro and its subsidiaries covering our arrangements in specified countries and regions. Each of these contracts has an independent duration, is independent of any other agreement (such as a master distribution agreement) and any

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termination of one agreement does not affect the status of any of the other agreements. In the first quarter of fiscal 2011, no single agreement with this distributor was responsible for over 10% of our total net revenue. If any one of our agreements with this distributor was terminated, we believe we could make arrangements with new or existing distributors to distribute our products without a substantial disruption to our business; however, any prolonged delay in securing a replacement distributor could have a negative short-term impact on our results of operations.

Successfully managing our indirect channel efforts to reach various potential customer segments for our products and services is a complex process. Our distributors are independent businesses that we do not control. Notwithstanding the independence of our channel partners, we face potential legal risk and reputational harm from the activities of these third parties including, but not limited to, export control violations, corruption and anti-competitive behavior.

Although we have undertaken efforts to reduce these third-party risks, they remain present. We cannot be certain that our distribution channel will continue to market or sell our products effectively. If we are not successful, we may lose sales opportunities, customers and revenues.

Our distributors also sell our competitors' products, and if they favor our competitors' products for any reason, they may fail to market our products as effectively or to devote resources necessary to provide effective sales, which would cause our results to suffer. We also distribute some products through our OEM channel, and if our OEMs decide not to bundle our applications on their devices, our results could suffer.

In addition, the financial health of our distributors and our continuing relationships with them are important to our success. Some of these distributors may be unable to withstand adverse changes in current economic conditions, which could result in insolvency of certain of our distributors and/or the inability of our distributors to obtain credit to finance purchases of our products. In addition, weakness in the end-user market could further negatively affect the cash flow of our distributors who could, in turn, delay paying their obligations to us, which would increase our credit risk exposure. Our business could be harmed if the financial condition of some of these distributors substantially weakens and we were unable to timely secure replacement distributors.

We also sell certain of our products and services through our direct sales force. Risks associated with this sales channel include a longer sales cycle associated with direct sales efforts, difficulty in hiring, retaining and motivating our direct sales force, and substantial amounts of training for sales representatives, including regular updates to cover new and upgraded products and services. Moreover, our recent hires and sales personnel added through our recent business acquisitions may not become as productive as we would like, as in most cases it takes a significant period of time before they achieve full productivity. Our business could be seriously harmed if these expansion efforts do not generate a corresponding significant increase in revenues and we are unable to achieve the efficiencies we anticipate.

We also provide products and services, directly and indirectly, to a variety of governmental entities, both domestically and internationally. The licensing and sale of products and services to governmental entities may require adherence to complex specific procurement regulations and other requirements. While we believe we have adequate controls in this area, failure to effectively manage this complexity and satisfy these requirements could result in the potential assessment of penalties and fines, harm to our reputation and lost sales opportunities to such governmental entities.

We outsource a substantial portion of our customer service and technical support activities to third-party service providers. We rely heavily on these third-party customer service and technical support representatives working on our behalf and we expect to continue to rely heavily on third parties in the future. This strategy provides us with lower operating costs and greater flexibility, but also presents risks to our business, including the possibilities that we may not be able to impact the quality of support that we provide as directly as we would be able to do in our own company-run call centers, and that our customers may react negatively to providing information to, and receiving support from, third-party organizations, especially if based overseas. If we encounter problems with our third-party customer service and technical support providers, our reputation may be harmed and our revenue may be adversely affected.

Catastrophic events may disrupt our business.

We are a highly automated business and rely on our network infrastructure and enterprise applications, internal technology systems and our Website for our development, marketing, operational, support, hosted services and sales activities. In addition, some of our businesses rely on third-party hosted services and we do not control the operation of third-party data center facilities serving our customers from around the world, which increases our vulnerability. A



disruption, infiltration or failure of these systems or third-party hosted services in the event of a major earthquake, fire, power loss, telecommunications failure, software or hardware malfunctions, cyber attack, war, terrorist attack, or other catastrophic event could cause system interruptions, reputational harm, loss of intellectual property, delays in our product development, lengthy interruptions in our services, breaches of data security and loss of critical data and could prevent us from fulfilling our customers' orders. Our corporate headquarters, a significant portion of our research and development activities, certain of our data centers, and certain other critical business operations are located in the San Francisco Bay Area, which is near major earthquake faults. We have developed certain disaster recovery plans and certain backup systems to reduce the potentially adverse effect of such events, but a catastrophic event that results in the destruction

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or disruption of any of our data centers or our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our future operating results could be adversely affected.

Net revenue, margin or earnings shortfalls or the volatility of the market generally may cause the market price of our stock to decline.

The market price for our common stock has experienced significant fluctuations and may continue to fluctuate significantly. The market price for our common stock may be affected by a number of factors, including shortfalls in our net revenue, margins, earnings or key performance metrics, changes in estimates or recommendations by securities analysts, the announcement of new products, product enhancements or service introductions by us or our competitors, seasonal variations in the demand for our products and services and the implementation cycles for our new customers, the loss of a large customer or our inability to increase sales to existing customers and attract new customers, quarterly variations in our or our competitors' results of operations, developments in our industry; unusual events such as significant acquisitions, divestitures and litigation, general socio-economic, regulatory, political or market conditions and other factors, including factors unrelated to our operating performance.

We are subject to risks associated with global operations which may harm our business.

We are a global business that generates over 50% of our total revenue from sales to customers outside of the Americas. This subjects us to a number of risks, including:

- foreign currency fluctuations;
- changes in government preferences for software procurement;
- international economic, political and labor conditions;
- tax laws (including U.S. taxes on foreign subsidiaries);
- increased financial accounting and reporting burdens and complexities;
- unexpected changes in, or impositions of, legislative or regulatory requirements;
- failure of laws to protect our intellectual property rights adequately;
- inadequate local infrastructure and difficulties in managing and staffing international operations;
- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers and restrictions;
- transportation delays;
- operating in locations with a higher incidence of corruption and fraudulent business practices; and
- other factors beyond our control, including terrorism, war, natural disasters and pandemics.

If sales to any of our customers outside of the Americas are delayed or canceled because of any of the above factors, our revenue may be negatively impacted.

In addition, approximately 46% of our employees are located outside the U.S. This means we have exposure to changes in foreign laws governing our relationships with our employees, including wage and hour laws and regulations, fair labor standards, unemployment tax rates, workers' compensation rates, citizenship requirements and payroll and other taxes, which likely would have a direct impact on our operating costs. We also intend to continue expansion of our international operations and international sales and marketing activities. Expansion in international markets has required, and will continue to require, significant management attention and resources. We may be unable to scale our infrastructure effectively, or as quickly as our competitors, in these markets and our revenues may not increase to offset these expected increases in costs and operating expenses, which would cause our results to suffer. Moreover, as a global company, we are subject to varied and complex laws, regulations and customs domestically and internationally. These laws and regulations relate to a number of aspects of our business, including trade protection, import and export control, data and transaction processing security, records management, gift policies, employment and labor relations laws, securities regulations and other regulatory requirements affecting trade and investment. The application of these laws and regulations to our business is often unclear and may at times conflict. Compliance with these laws and regulations may involve significant costs or require changes in our business practices that result in reduced revenue and profitability. Non-compliance could also result in fines, damages, criminal sanctions against us, our officers, or our employees, prohibitions on the conduct of our business, and damage to our reputation. We incur additional legal compliance costs associated with our global operations and could become subject to legal penalties in

foreign countries if we do not comply with local laws and regulations, which may be substantially different from those in the U.S. In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by U.S. regulations applicable to us such as the Foreign Corrupt

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Practices Act. Although we implement policies and procedures designed to ensure compliance with these laws, there can be no assurance that all of our employees, contractors and agents, as well as those companies to which we outsource certain of our business operations, including those based in or from countries where practices which violate such U.S. laws may be customary, will not take actions in violation of our internal policies. Any such violation, even if prohibited by our internal policies, could have an adverse effect on our business.

We may incur losses associated with currency fluctuations and may not be able to effectively hedge our exposure.

Our operating results are subject to fluctuations in foreign currency exchange rates. We attempt to mitigate a portion of these risks through foreign currency hedging, based on our judgment of the appropriate trade-offs among risk, opportunity and expense. We have established a hedging program to partially hedge our exposure to foreign currency exchange rate fluctuations for various currencies. We regularly review our hedging program and make adjustments as necessary based on the judgment factors discussed above. Our hedging activities may not offset more than a portion of the adverse financial impact resulting from unfavorable movement in foreign currency exchange rates, which could adversely affect our financial condition or results of operations.

We have issued \$1.5 billion of notes in a debt offering and may incur other debt in the future, which may adversely affect our financial condition and future financial results.

In the first quarter of fiscal year 2010 we issued \$1.5 billion in senior unsecured notes. We also have a currently undrawn \$1.0 billion revolving credit facility. Although we have no current plans to request any advances under this credit facility, we may use the proceeds of any future borrowing for general corporate purposes or for future acquisitions or expansion of our business.

This debt may adversely affect our financial condition and future financial results by, among other things: requiring the dedication of a portion of our expected cash from operations to service our indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures and acquisitions; and

limiting our flexibility in planning for, or reacting to, changes in our business and our industry.

Our senior unsecured notes and revolving credit facility impose restrictions on us and require us to maintain compliance with specified covenants. Our ability to comply with these covenants may be affected by events beyond our control. If we breach any of the covenants and do not obtain a waiver from the lenders or noteholders, then, subject to applicable cure periods, any outstanding indebtedness may be declared immediately due and payable.

In addition, changes by any rating agency to our credit rating may negatively impact the value and liquidity of both our debt and equity securities. Under certain circumstances, if our credit ratings are downgraded or other negative action is taken, an increase in the interest rate payable by us under our revolving credit facility could result. In addition, any downgrades in our credit ratings may affect our ability to obtain additional financing in the future and may affect the terms of any such financing.

Changes in, or interpretations of, accounting principles could result in unfavorable accounting charges.

We prepare our Condensed Consolidated Financial Statements in accordance with GAAP. These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles can have a significant effect on our reported results and may even retroactively affect previously reported transactions. Our accounting principles that recently have been or may be affected by changes in the accounting principles are as follows:

- software and subscription revenue recognition; and
- accounting for business combinations and related goodwill.

In December 2007, FASB issued revised standards for business combinations, which changes the accounting for business combinations including timing of the measurement of acquirer shares issued in consideration for a business combination, the timing of recognition and amount of contingent consideration, the accounting for pre-acquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring liabilities, the treatment of acquisition-related transaction costs and the recognition of changes in the acquirer's income tax valuation allowance. The revised standards for business combinations were effective for us beginning the first quarter of fiscal 2010. We have and will continue to incur expenses related to acquisitions and this will have an impact on our financial performance.

In October 2009, the FASB amended the accounting standards for certain multiple deliverable revenue arrangements to: (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated; (2) require an entity to allocate revenue in an arrangement using the best estimated selling price (“BESP”) of deliverables if a vendor does not have vendor-specific objective evidence (“VSOE”) of selling price or third-party evidence (“TPE”) of selling price; and (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. We elected to early adopt this accounting guidance at the beginning of our first quarter of fiscal year 2010 on a prospective basis for applicable transactions originating or materially modified after November 27, 2009. The new accounting standards for revenue recognition if applied in the same manner to the year ended November 27,

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2009 would not have had a material impact on total net revenues for that fiscal year. In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a significant effect on total net revenues in periods after the initial adoption when applied to multiple-element arrangements based on current go-to-market strategies due to the existence of VSOE across certain of our product and service offerings. However, we expect that the new accounting standards will enable us to evolve our go-to-market strategies which could result in future revenue recognition for multiple element arrangements to differ materially from the results in the current period. Changes in the allocation of the sales price between elements may impact the timing of revenue recognition, but will not change the total revenue recognized on the contract. We are currently unable to determine the impact that the newly adopted accounting principles could have on our revenue as these go-to-market strategies evolve.

If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.

Under GAAP, we review our goodwill and amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, future cash flows, and slower growth rates in our industry. We may be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, resulting in an impact on our results of operations.

Changes in, or interpretations of, tax rules and regulations may adversely affect our effective tax rates.

We are a United States-based multinational company subject to tax in multiple U.S. and foreign tax jurisdictions. A significant portion of our foreign earnings for the current fiscal year were earned by our Irish subsidiaries. In addition to providing for U.S. income taxes on earnings from the U.S., we provide for U.S. income taxes on the earnings of foreign subsidiaries unless the subsidiaries' earnings are considered permanently reinvested outside the U.S. While we do not anticipate changing our intention regarding permanently reinvested earnings, if certain foreign earnings previously treated as permanently reinvested are repatriated, the related U.S. tax liability may be reduced by any foreign income taxes paid on these earnings.

Our income tax expense has differed from the tax computed at the U.S. federal statutory income tax rate due primarily to discrete items and to earnings considered as permanently reinvested in foreign operations. Unanticipated changes in our tax rates could affect our future results of operations. Our future effective tax rates could be unfavorably affected by changes in the tax rates in jurisdictions where our income is earned, by changes in, or our interpretation of, tax rules and regulations in the jurisdictions in which we do business, by unanticipated decreases in the amount of earnings in countries with low statutory tax rates, by lapses of the availability of the U.S. research and development tax credit, or by changes in the valuation of our deferred tax assets and liabilities.

In addition, we are subject to the continual examination of our income tax returns by the Internal Revenue Service ("IRS") and other domestic and foreign tax authorities, including a current examination by the IRS of our fiscal 2008 and 2009 tax returns. These examinations are expected to focus on our intercompany transfer pricing practices as well as other matters. We regularly assess the likelihood of outcomes resulting from these examinations to determine the adequacy of our provision for income taxes and have reserved for potential adjustments that may result from the current examinations. We believe such estimates to be reasonable; however, there can be no assurance that the final determination of any of these examinations will not have an adverse effect on our operating results and financial position.

If we are unable to recruit and retain key personnel our business may be harmed.

Much of our future success depends on the continued service and availability of our senior management. These individuals have acquired specialized knowledge and skills with respect to Adobe. The loss of any of these individuals could harm our business. Our business is also dependent on our ability to retain, hire and motivate talented, highly skilled personnel. Experienced personnel in the information technology industry are in high demand and competition for their talents is intense, especially in the San Francisco Bay Area, where many of our employees are located. We have relied on our ability to grant equity compensation as one mechanism for recruiting and retaining such highly

skilled personnel. Accounting regulations requiring the expensing of equity compensation may impair our ability to provide these incentives without incurring significant compensation costs. If we are unable to continue to successfully attract and retain key personnel, our business may be harmed. Effective succession planning is also a key factor for our long-term success. Our failure to enable the effective transfer of knowledge and facilitate smooth transitions with regards to our key employees could adversely affect our long-term strategic planning and execution.

We believe that a critical contributor to our success to date has been our corporate culture, which we believe fosters innovation and teamwork. As we grow, including from the integration of employees and businesses acquired in connection with our previous or future acquisitions, we may find it difficult to maintain important aspects of our corporate culture which could negatively affect our ability to retain and recruit personnel and otherwise adversely affect our future success.

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Our investment portfolio may become impaired by deterioration of the capital markets.

Our cash equivalent and short-term investment portfolio as of March 4, 2011 consisted of corporate bonds and commercial paper, foreign government securities, money market mutual funds and repurchase agreements, municipal securities, U.S. agency securities and U.S. Treasury securities. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes.

Should financial market conditions worsen in the future, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of March 4, 2011, we had no material impairment charges associated with our short-term investment portfolio, and although we believe our current investment portfolio has very little risk of material impairment, we cannot predict future market conditions or market liquidity, or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.



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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Below is a summary of stock repurchases for the three months ended March 4, 2011. See Note 12 of our Notes to Condensed Consolidated Financial Statements for information regarding our stock repurchase program.

| Period  | Shares Repurchased                             | Average Price Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Approximate Dollar Value that May Yet be Purchased Under the Plan <sup>(1)</sup> |
|---|--|-------------------------|--|--|
|   | (in thousands, except average price per share) |                         |  |  |
| Beginning repurchase authority December 4—December 31, 2010 |  |                         |  | 1,000,000  |
| Shares repurchased January 1—January 28, 2011               | —  | \$—                     | —  | \$—  |
| Shares repurchased January 29—March 4, 2011                 | 1,298  | \$32.11                 | 1,298  | \$(41,667 ) <sup>(2)</sup>   |
| Shares repurchased  | 1,241  | \$33.61                 | 1,241  | \$(41,715 )  |
| Total   | 2,539  |                         | 2,539  | \$916,618  |

<sup>(1)</sup> In June 2010, our Board of Directors approved an amendment to change our stock repurchase program from a non-expiring share-based authority to a time-constrained dollar-based authority. As part of this amendment, the Board of Directors granted authority to repurchase up to \$1.6 billion in common stock through the end of fiscal 2012.

<sup>(2)</sup> In January 2011, as part of the amended program, we entered into a structured stock repurchase agreement with a large financial institution whereupon we provided them with a prepayment of \$125.0 million. As of March 4, 2011, \$41.6 million of prepayments remained under this agreement.

## ITEM 6. EXHIBITS

The exhibits listed in the accompanying “Index to Exhibits” are filed or incorporated by reference as part of this Form 10-Q.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ADOBE SYSTEMS INCORPORATED

By        /s/ MARK GARRETT  
            Mark Garrett  
            Executive Vice President and  
            Chief Financial Officer  
            (Principal Financial Officer)

Date: April 7, 2011

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SUMMARY OF TRADEMARKS

The following trademarks of Adobe Systems Incorporated or its subsidiaries, which may be registered in the United States and/or other countries, are referenced in this Form 10-Q:

Adobe  
Acrobat  
Adobe Connect  
ColdFusion  
Creative Suite  
LiveCycle  
Omniture  
Photoshop  
Scene7

All other trademarks are the property of their respective owners.

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INDEX TO EXHIBITS

| Exhibit<br>Number | Exhibit Description   | Incorporated by Reference** |         |        | Filed<br>Herewith |
|-------------------|---|-----------------------------|---------|--------|-------------------|
|                   |   | Form                        | Date    | Number |                   |
| 3.1               | Amended and Restated Bylaws   | 8-K                         | 1/13/09 | 3.1    |                   |
| 3.2               | Restated Certificate of Incorporation of Adobe Systems Incorporated |                             |         |        |                   |